



Guidance on the Privatization of Federally Funded Wastewater Treatment Works





UNITED STATES ENVIRONMENTAL PROTECTION AGENCY
WASHINGTON, D.C. 20460

OFFICE OF
WATER

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MEMORANDUM

SUBJECT: Guidance on the Privatization of Federally
Funded Wastewater Treatment Works

FROM: Michael B. Cook, Director
Office of Wastewater Management

TO: All Interested Parties

I am pleased to provide you with the Agency's document entitled "Guidance on the Privatization of Federally Funded Wastewater Treatment Works." This guidance was designed to provide a general understanding of privatization and the process local governments should follow if they choose to privatize wastewater facilities which were financed with grants from the Agency's construction grant programs (i.e. PL 84-660 & PL 92-500), research and demonstration programs and special Congressional appropriations.

The guidance provides an overview of the wastewater public-private partnership process. The overview includes a history of privatization, the financial and non-financial issues associated with privatization, plus a description of the most common types of privatization agreements.

The discussion on the financial factors affecting privatization addresses the issues of cost savings, tax status of debt, capital improvements, economic risks, and local/regional economic impacts. The non-financial factors discussed include regulatory compliance, labor, responsibility for capital improvements, municipal control, accountability and rate stability.

The guidance discusses how contract operations and disposition types of privatization agreements are related to the Agency's grant regulations and Executive Order 12803 on "Infrastructure Privatization." Contract operation arrangements usually involves a facility's operations, maintenance, equipment replacement and possible capital improvements. Disposition arrangements usually occur when the private entity provides some type of payments to the local government. Disposition arrangements must undergo Agency review and approval. Specific details about these privatization arrangements are discussed on pages 12 -15 of the guidance.

The guidance describes the information federal wastewater grantees should submit to the Agency for review of their proposed privatization agreement. This information is generally presented in an executive summary which addresses all salient facts about the privatization agreement.

The Agency's criteria used to approve proposed privatization agreements are delineated in the guidance to facilitate an understanding of the Agency's privatization objectives. The Agency reviews privatization agreements to ensure compliance with the intent of the Clean Water Act, the National Pollutant Discharge Elimination System program, the Resource Conservation and Recovery Act, the requirements of Executive Order 12803, and protection of the wastewater users.

I trust that the information contained in this guidance will be helpful to communities contemplating the privatization of their wastewater treatment facilities. An electronic version of the guidance is located on the Internet at www.epa.gov/owm/prigud.htm . If you have any questions about the application of this guidance, please do not hesitate to contact me or the Agency's Privatization Coordinator, Haig Farmer, at 202/260-7279 or e-mail at farmer.haig@epa.gov .

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CHAPTER 1

Introduction

For approximately 40 years, the federal government has been a full partner with the states and local governments in meeting the Nation's wastewater treatment needs. Since 1972, more than \$67 billion of federal funds have been invested in wastewater treatment works through the Environmental Protection Agency's (EPA's) Construction Grant program. In 1987, Congress initiated the phase out of the Construction Grants program, replacing it with the Clean Water State Revolving Fund (SRF) program.

The SRF program provides low-interest loans to communities for the construction of water pollution control infrastructure projects. Federal and state investments to date of more than \$20 billion ensure that the SRF program will play an important role in funding water pollution control projects into the future. However, even with continued capitalization, the SRF program will not address all of the water pollution infrastructure needs of local governments, which have been estimated to be about \$200 billion. This estimate excludes the costs required to replace aging pipes and plants. As a result, it is important to fully explore other funding approaches at the local level to meet infrastructure needs.

One approach to consider is the use of public-private partnerships that utilize private sector resources to finance wastewater treatment needs. The private sector has historically been involved in providing wastewater treatment related services to local governments. Whether providing basic wastewater treatment supplies (e.g., chemicals), maintaining a portion of the collection or treatment system under a contract, or providing contract operation and maintenance for all of a municipality's facilities, the private sector has served an important role in the effort to control water pollution across the country.

In 1992, Presidential Executive Order 12803 increased interest in using private sector financial resources to meet local government wastewater funding needs. Executive Order 12803 directed federal agencies to remove regulatory or procedural obstacles to privatization that were under their control. It also allowed the accelerated depreciation of the federal government's financial interest in grant funded facilities and recovery of the local investment prior to recovery of any federal grant funds. At the same time, the Executive Order protected the existing public wastewater investment by requiring that privatized federally funded facilities continue to serve their original purposes.

Although the vast majority of municipal wastewater facilities are publicly owned and operated, there are many examples of successful private operations of municipal facilities. Privatization should be viewed as an option for providing wastewater treatment services and capital needs. The decision to privatize is the responsibility of the local governments and should reflect a balanced evaluation of the financial and non-financial issues with the needs of the community.

When the wastewater treatment works were constructed solely with state revolving loans or local funds, EPA is not involved in the privatization process (See Appendix B). If Federal grants were used to construct the treatment works, EPA must review and approve all disposition types of arrangements (See page 12) proposed by local governments. However, EPA does not review or approve contract operations types of agreements (See page 9). The Office of Management and Budget must also approve disposition types of agreements where the transaction prices are not established by full and open competition.

Objectives

This guidance has three major objectives. First, it is intended to provide an overview for the privatization of Publicly Owned Wastewater Treatment Works (POTW) that have been financed with grant funds from EPA's construction grant programs (i.e. PL 84-660 and PL 92-500), research and demonstration programs and special Congressional appropriations. This guidance will serve as a reference for local governments and private companies that are interested in obtaining an introductory understanding of the privatization process. Second, this document provides an overview of the factors that should be considered by a local government evaluating privatization, and finally, it describes the information local governments must develop for EPA's review and approval of proposed disposition types of arrangements.

Summary of Potential for Public-Private Partnerships

The private sector has the potential to be a significant partner in the development of wastewater infrastructure in this country. The private sector has ready access to financial markets which could be made available for wastewater infrastructure needs when a local government enters into a private partnership arrangement for its public wastewater facilities. Financial markets may find these investments attractive because the local government guarantees that it will pay its private partner a fixed service fee for wastewater treatment. The local government's wastewater assets also provide a form of collateral to assure the private lenders that their loan will be repaid by the borrower.



The decision by the local government to privatize its wastewater assets involves an evaluation of many financial and non-financial factors. A primary consideration is that any wastewater capital funds obtained through either local government or private sources must be repaid by the wastewater users. Privatization is simply another source of capital funds available to local governments that must be repaid to the lenders. Thus, privatization is never a source of free capital.

The EPA believes the decision to privatize is the responsibility of the local government based on an analysis of the locality's unique circumstances. In anticipation that some local governments will choose privatization, the EPA has worked closely with the Internal Revenue Service and the Office of Management and Budget to remove federal administrative impediments to the privatization process. In addition, the EPA has streamlined its administrative procedures to assist its wastewater construction grantees with their privatization efforts by delegating the EPA's review and approval authority under Executive Order 12803 to the Assistant Administrator for Water.

Organization of Guidance

This guidance provides an overview of the wastewater public-private partnership process. It presents the most common privatization arrangements, the financial and non-financial issues associated with privatization, plus a description of the EPA privatization review and approval process. The major sections of the guidance are:

Overview of privatization - discusses the history and the appeal of privatization and the most common types of public-private partnership arrangements.

Analysis of the factors affecting privatization arrangements - discusses the financial and non-financial factors encompassing public-private partnership arrangements.

The federal review and approval process - discusses the purpose of EPA's review and the factors considered in the approval.

Overview of Privatization

CHAPTER 2

The generic term privatization encompasses a broad range of private sector participation in public services. Partnerships between the public and private sectors in the water and wastewater industry range from providing basic services and supplies to the design, construction, operation, and ownership of public utilities. The primary focus of this guidance is local government's use of the private sector to finance and operate their wastewater facilities. The basic reasons that the public sector historically privatized services were to realize cost savings, utilize expertise, achieve efficiencies in construction and operation, access private capital, and improve the quality of wastewater services.

As the pace of constructing water pollution control facilities escalated in the 1970s, due to federal and state environmental legislation and EPA's Construction Grant program, there was an increased interest by the private sector in wastewater operations. In the 1980s, the availability of tax incentives (tax-exempt debt, accelerated depreciation, and investment tax credits) for private investment in public utilities stimulated interest in the privatization of publicly owned wastewater treatment works (POTW). However, tax laws and Internal Revenue Service (IRS) rulings that affect privatization have been modified over the years. The Tax Reform Act of 1986 removed many of the tax incentives for public-private partnerships and reduced interest in certain types of privatization. In 1997, IRS Revenue Procedure 97-13 on Qualified Tax-Exempt Bonds allowed management contracts for up to 20 years instead of the 5 year period previously allowed. This change provides a longer recovery period for any private investments in a POTW.

Executive Order 12803 was issued in 1992 to simplify federal requirements related to the disposition of the federal interest in grant-funded infrastructure facilities. The Executive Order defines privatization as *"the disposition or transfer of an infrastructure asset, such as by sale or by long-term lease, from a State or local government to a private party."* The generic term privatization includes the Executive Order privatization definition. Where federal grants have been used to fund a facility, the privatization transactions of federal grantees must comply with federal construction grant and property disposition regulations. When non-operational revenues (e.g., concession, site access, host, transfer or other types of payments) are received by federal grantees from a private entity as a result of a privatization agreement, these revenues represent a disposition or transfer of a part or all of the grantee's interests in the asset under the Executive Order meaning of privatization. As a result, the grantee

Local governments
use private sector
to finance and
operate facilities.



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There has been
increased interest
in public-private
partnerships.

must request and receive approval from EPA for the proposed privatization agreement (“disposition agreement”) and obtain a deviation from the federal grant regulations to dispose of and end the federal interest in the asset.

The Executive Order allows state and local wastewater treatment investments to be recovered from the proceeds of disposition agreements prior to any claim by the federal government for the funds provided by EPA construction grants. Repayment of federal grants only occurs to the extent that the non-operational revenues received by the grantee exceed local, and possibly the state, investment in the assets. The Executive Order allows grant funds to be recouped at their depreciated value. In the event that all EPA construction grants are fully depreciated, there is no federal grant recoupment. However, even when grants are fully depreciated, Executive Order 12803 and federal grant regulations requires EPA to approve disposition types of privatization agreements and issue deviations from the applicable grant regulations.

Other Executive Orders that affect privatization include Executive Order 12875, which directs federal agencies to review their regulatory requirements with respect to wastewater privatization, and Executive Order 12893, which encourages agencies to seek public-private partnerships, and in conjunction with state and local governments, to remove regulatory and legal barriers to privatization.

This guidance focuses special attention on contract operations and disposition types of privatization agreements. Contract operations agreements involve operations, maintenance, equipment replacement and management services. Contract operations agreements also allow infrastructure investments by the private entity under specific contract provisions. Contract operations agreements are not subject to EPA review and approval under Executive Order 12803 or the EPA’s grant regulations.

Disposition agreements, as defined by the Federal government, occur when a private entity encumbers the asset’s title or other interest and usually involve the payment of non-operational revenues to the local government in various forms such as, for example, concession fees, site access fees, or the transfer price. Under the federal definitions governing grant programs, any non-operational revenue received from a private entity constitutes an encumbrance, transfer, or disposition of the grantee’s interest in the grant funded asset. The grant regulations do not allow a grantee to encumber, dispose of, or transfer its interest in the asset to a private entity without federal approval. As part of EPA’s review and approval of disposition agreements, the Agency issues deviations from the federal grant regulations that protect the federal interest in the asset.

The Current Level of Privatization

Historically, public wastewater collection and treatment services have primarily been provided by local governments. However, small subdivisions and trailer parks have traditionally used privately owned and operated wastewater services since their inception. Unlike utilities such as electricity or natural gas, which have been viewed by the public as necessities to every household and local business, the demand for water pollution control most often reflected a region-wide need to address the threat of water pollution to public health. As a result, while the private sector often provided the utility services for gas, telephone, cable and electricity to the public, local governments provided wastewater services to ensure health protection for its citizens from municipal and industrial pollution.

Over time, the participation of the private sector in directly providing water-related services has grown within the United States. Public drinking water systems are frequently owned by private companies (over 40 percent of drinking water systems are private, regulated utility systems). Privatization of public wastewater treatment has been less common. It is somewhat difficult to obtain exact growth estimates for wastewater privatization because much of the information is proprietary. Recent industry newsletters and reports give a general indication that growth is occurring. One report indicates that in terms of dollars spent, less than 2 percent of the wastewater industry is privatized. Reports indicate that there are 280 small to mid-size (1 to 10 million gallons per day (mgd)) facilities and 40 large facilities (over 10 mgd) now using private partners for wastewater operations. Public-private contract operations are reported to have grown annually at a rate of 15-20 percent, and produced revenues of \$1.1 billion out of the \$23 billion expended for POTWs. Nearly all of the privatization has been in the form of contract operations. While many communities have explored the outright sale of facilities to private entities as allowed under Executive Order 12803, this option has rarely been used in the wastewater area primarily because of discharge permit and tax-related issues. These issues are fully discussed in this guidance.

The Appeal of Privatization

In recent years, local governments have become more focused on the benefits of privatization at the same time that the private sector is anxious to expand markets and revenues. Some of the reasons for the increased interest in privatization by local governments include the desire to increase efficiency of local government operations, reduce costs of providing services, improve environmental protection, and access private capital for infrastructure investment.

Increased efficiency—Private companies may be able to operate facilities more efficiently while meeting permit limits. The private companies often will employ

innovative operation and maintenance methods, as well as equipment for wastewater treatment that require significant capital investment. The private sector is also able to draw on substantial experience in the operation of treatment facilities and take advantage of wholesale prices of supplies and materials needed for a facility's successful operation. The private company can frequently use its management expertise to stabilize user fees for the period of the privatization agreement.

Cost reduction—Often the opportunity to realize cost savings is the primary reason that local governments are attracted to privatization. In many cases, private ownership/operation makes sense because it lowers costs. Depending on the type of privatization selected, surveys indicate the private treatment systems can operate at costs savings compared to public treatment systems. Capital cost savings can be substantial when the private partner uses advanced technology coupled with streamlined procurement and construction practices. Local governments that are able to identify and implement the cost-saving management techniques that would be undertaken by a private company may be able to reduce costs similarly to the private sector. This can occur because the public sector has several cost-related advantages over the private sector. First, the public sector does not have to make a profit on its operations and capital investments. Second, the public sector has better access to tax-exempt debt financing that results in lower borrowing costs for capital projects.

Environmental benefits—Some government facilities may have problems complying with discharge permit limits because of needed capital improvements, maintenance costs that exceed budgetary allocations, or difficulty in maintaining skilled personnel. Where local governments have had difficulty meeting permit limits, privatization may result in real environmental benefits. Private companies can readily make capital investments under the conditions of the service contract and dedicate highly skilled personnel to ensure efficient operation and compliance with facility discharge permit requirements.

Access to capital—One of the major benefits of privatization is that it provides access to private sector capital. This may be an attractive feature of privatization for communities with limited access to capital markets. However, as with public financing, the use of private capital will require that user fees are adjusted to recoup the capital investment plus interest. When privatization arrangements include capital investments in the form of an up-front transfer of funds (e.g., transfer price in an asset sale or concession fees in disposition agreements), such investments can be viewed as loans from the private entity to the local government. Up-front fund transfers from the private entity that are part of a privatization arrangement will require local wastewater users to



repay the up-front funds plus interest to the private entities. An increase in user fees can result when the transfer price or concession fees effectively replace and exceed the previously outstanding local debt on the wastewater treatment facilities because equity is taken out of the facility.

Types of Privatization

Municipalities seeking privatization agreements have a range of options to consider from the status quo of continued municipal ownership and operation to complete private ownership and operation. Often a local government will evaluate the expected cost of continued public operation with various privatization proposals. Currently, the most widely discussed types of wastewater privatization are contract operations and disposition agreements.

The specific application of each privatization type will vary by location, since local governments have different conditions and requirements. For example, some communities may find privatization attractive because they are having difficulty meeting permit requirements due to lack of skilled personnel or extremely challenging water pollution treatment conditions. Other communities may wish to evaluate privatization when undergoing major facility expansions or rehabilitation in hopes of achieving greater economies by attracting competitive facility design, construction and operation bids from the private sector. Because privatization situations are not identical, this guidance focuses on a presentation of the general structure of widely used types of wastewater privatization and the factors leading to the selection of a privatization type. The determination of whether a privatization agreement is classified as a contract operations or disposition type of agreement for the purposes of EPA review and approval of privatization agreements for grant funded wastewater facilities is based on the overall function of the contract as defined in its specific conditions. The nomenclature used by attorneys, state and local governments to describe privatization agreements does not influence the EPA's classification of the agreements.

Contract operations—For many years municipalities have used the flexibility of contracting with private entities for providing selected functions ranging from janitorial services to vehicle fleet management and equipment maintenance. Municipalities have found that contracting can be a good way to obtain services, acquire specialized skills not available in the municipal pool of employees, or introduce competition into the governmental services arena.

In the area of water pollution control, municipalities have employed many different levels of contract operations. In full contract operations, the private entity manages, operates and maintains the wastewater treatment system. All aspects of wastewater operation and maintenance are performed by the private entity. The collection of user fees can also be assigned to the private entity even though the authority for establishing user rates is retained by a public entity or utility authority.

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Under contract
operations, the
private entity
manages,
operates, and
maintains
the facility.

In partial contract operations, the private entity operates only certain areas of the facility. For example, a private entity can be contracted to haul sludge on an as needed basis, or maintain a plant's centrifugal force extractors for a specific time period. The private entity has its obligations specified and limited through the terms of the contract. Normally the contract will specify a fixed fee for the specific services. Typically the contract fees increase annually with inflation or by another index.

With contract operations types of privatization arrangements, the facilities are operated for a fixed length of time. Until recently, IRS management contract rules for water and wastewater facilities financed with tax-exempt municipal bonds allowed a maximum of five years for contract operations without affecting the status of the municipal tax-exempt bonds. Private entities and local governments generally viewed this term as too short, limiting the economic benefits that could result from longer term contract arrangements. For example, with the assurance of a longer term contract, private entities are able to make a long-term commitment of expert staff or equipment to effectively operate and maintain a facility. Rule changes from the IRS in January of 1997 have addressed this concern by allowing management contracts for water and wastewater treatment facilities of up to 20 years under specific contract conditions.

Contract operations arrangements between private entities and local governments that received EPA construction grants do not require Agency review and approval prior to signing the contract. The contract operations agreements may include cash transfers from the private entity to the municipality for the documented transaction costs the municipality incurs to establish the agreement or an amount less than one percent of the present value of the contract. They may also include capital investments by the private entity provided the resulting assets remain the sole property of the local government when construction is complete and the private entity would not have any claim on the facilities as a result of the capital investment. Since capital investments by the private entity represents a loan to the local government, the private entity must have written assurances of recovering its capital investment in the event of

PRIVATIZATION EXAMPLE: CONTRACT OPERATIONS

Facility Ownership: Local government

Contract type: Contract operations for operation, maintenance, and equipment replacement over a 15 year time period

Facility constructed in part with federal grants: Yes

Up-front or periodic payments from private partner: Only documented, auditable contract transaction costs

Private partner invests in new capital improvements: Yes

Privatization arrangement under E.O. 12803: No, contract operation

EPA review and approval: None: However, requires state notification of privatization agreement and possible modification of NPDES permit

Permittee: Local government and private company may be copermittees on NPDES permit

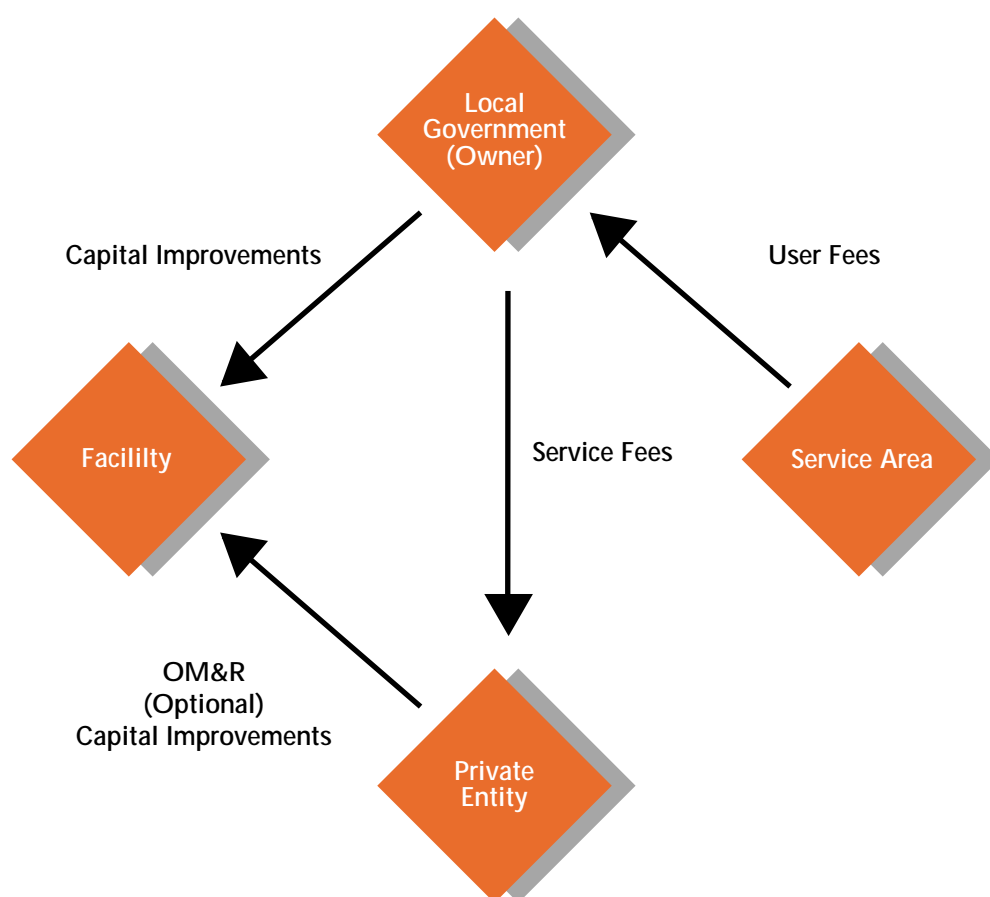
early termination of the agreement to avoid having a contract operations agreement becoming a disposition agreement. Therefore, contract operations agreements involving capital investments would provide for local government reimbursement of the private entity's unrecovered capital investment in the event of premature contract termination. Capital investments generally are expenditures for the purpose of improving operational efficiencies and increasing the capacity or treatment levels of the facility.

A contract operations form of privatization agreement usually requires the private entity to operate and maintain the facilities for a specific time period (See Figure 1). Maintaining the facilities includes the repair, upgrade, or replacement of equipment so the facilities will continue to perform their originally intended purposes.

Some local governments limit a private entity's equipment replacement costs under the contract to a specific dollar amount with the local government funding the costs above the specified amount. When the contract does not have an upper limit on equipment replacement costs, the private entity must carefully evaluate facility maintenance records to accurately establish its service fee for the contract.

Contract operations agreements do not require EPA review and approval if the contractor pays either the documented, auditable contract transaction costs or an amount less than one percent of the present value of the contract. When either an initial or periodic non-operational payment exceeds these amounts, EPA and OMB consider the contract a disposition agreement under EPA regulations and Executive Order 12803. Disposition agreements require Agency review and approval prior to signing the contract. Under EPA's administration of its property disposition and grant regulations, any concession type payment or non-operational revenue payments to the local government results in the private entity encumbering the title or other interests in the asset. A privatization agreement that involves non-operational or periodic payments

Figure 1: **Contract Operation**



to the local government may be considered a contract operation type arrangement by some parties, however, EPA views these types of agreements as disposition agreements that must receive prior Agency approval.

Under contract operations, a local government must maintain unencumbered ownership of the facility at all times. The local government must retain control and responsibility for all capital investment in the wastewater facility, setting rates, collecting user fees, and enforcement of the municipal industrial pretreatment program (MIPP). The local government must maintain primary responsibility for all interactions with the federal and state regulators. The private partner is paid a service fee to cover the costs of management, operation, maintenance, equipment replacement, capital investments and other services as specified in the contract. Performance by the private entity will be maintained through close contract monitoring by the public partner and strict contract clauses that stipulate the actions to be taken in the event of non-performance by the private entity. The performance clauses usually includes financial penalties for non-performance.

Disposition Agreements—The Clean Water Act established EPA’s Construction Grants program and specified that grants should be awarded to publicly owned treatment works. The term publicly owned has been established to mean 100 percent ownership by a public entity. When a private entity invests in a publicly owned federally grant assisted treatment works, the action triggers the disposition and compensation requirements of EPA’s grants and property disposition regulations unless prior Agency approval is obtained under Executive Order 12803 with the appropriate grant deviations.

The Office of Management and Budget (OMB) promulgated Circular A-102 to ensure consistency and uniformity among federal agencies in the administration of grants to state and local governments. One area of standardization is the uniform treatment of property acquired in whole or in part with federal funds, or whose cost was charged to a project supported by a federal grant. The uniform standards include a prescription for the use and disposition of property acquired under a grant. EPA administers these uniform administrative requirements through its general grant regulations at 40 CFR Parts 30 and 31, plus the Agency’s construction grant regulations at 18 CFR Part 601 and 40 CFR 35 (See Appendix F).

OMB Circular A-102, Attachment M established the requirement that any federal grantee assure that “it will not dispose of or encumber its title or other interests in the site and facilities during the period of federal interest or while the government holds bonds, whichever is longer.” When local governments applied for EPA grant assistance to fund local wastewater treatment works, they agreed not to dispose or encumber the proposed facilities during the period of federal interest. This means that property acquired under a grant can not be sold or pledged as collateral in the

event the grantee needs to refinance the grant funded facility. This condition limits the grantee's ability to draw on the federal equity invested in the facility to raise additional capital during the period of federal interest. By giving this assurance the recipient agrees to retain the financial structure in place at the time of the grant award. This ensures the federal agency that the financial structure it approved at the time of grant award will not be changed without the appropriate grant deviations to dispose of the federal interest.

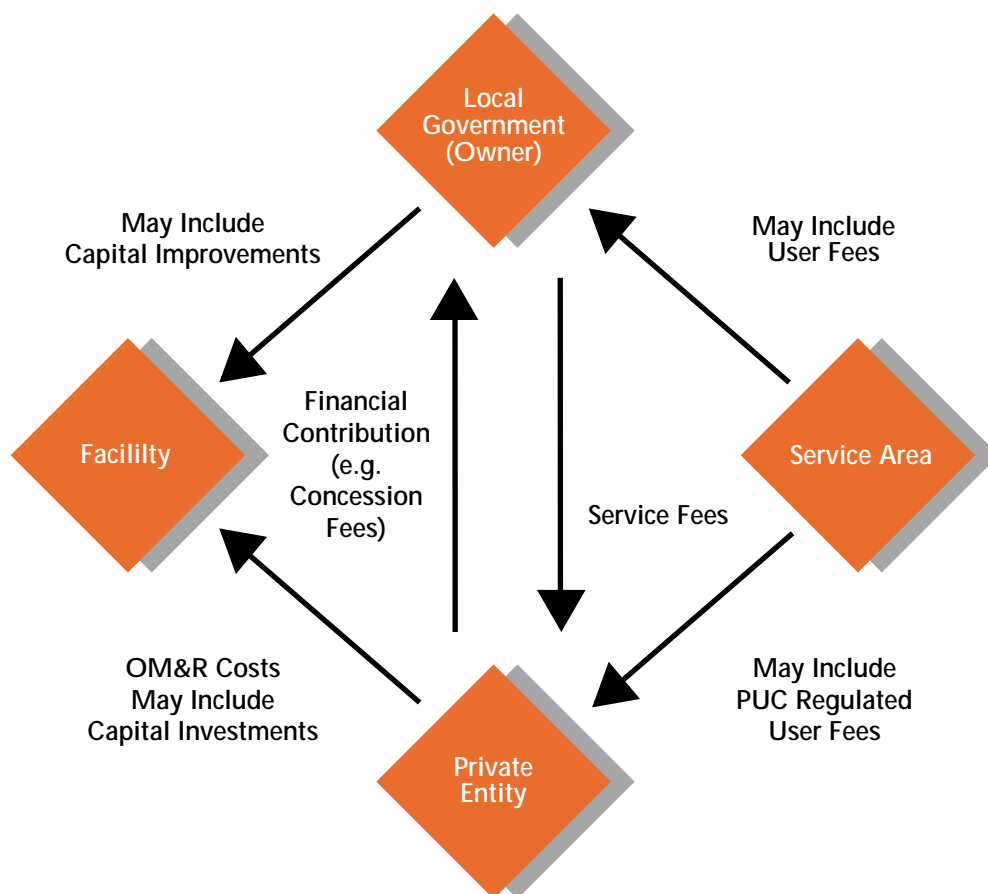
OMB Circular A-102, Attachment N established the requirement that the title to real property shall vest in the recipient subject to the condition that the grantee shall use the real property for the authorized purpose of the original grant as long as needed by the grantee. This rule effectively limits the grantee's use of its federally funded property, or discrete portions of that property, to its originally authorized purpose.

OMB Circular A-102 and the supporting EPA regulations regarding the use and disposition of federally funded property pose barriers to leases, sales and other types of disposition privatization agreements for local governments which received EPA grant funds. Therefore, to facilitate private involvement in federally funded assets, Executive Order 12803 was issued in 1992 to simplify federal requirements related to the disposition or transfer of the federal interest in grant-funded infrastructure facilities. The Executive Order allows state and local wastewater treatment investments to be recovered from the proceeds of disposition agreements prior to any claim by the federal government for the funds provided by EPA grants. Repayment of federal grants only occurs to the extent that the non-operational revenues received by the grantee exceed local, and possibly the state, investment in the asset. The Executive Order also allows federal grant funds to be recouped at their depreciated value. In the event that all EPA grants are fully depreciated, there would be no federal grant recoupment. However, even when grants are fully depreciated, Executive Order 12803 and federal grant regulations require EPA's prior approval for disposition types of privatization agreements and the issuance of deviations from applicable grant regulations to dispose of the federal interest.

The Executive Order defines privatization as *"the disposition or transfer of an infrastructure asset, such as by sale or by long-term lease, from a State or local government to a private party."* The EPA's approval of a disposition agreement under Executive Order 12803 is necessary prior to the initiation of the agreement in order to avoid implementation of the federal compensation procedures which results in the repayment of a portion of the grant funds (See Chapter 6—Disposition and Compensation Requirements). Therefore, when EPA provides prior approval of disposition types of agreements with the appropriate deviations from grant regulations, the Agency disposes of and ends its interest in the federally funded asset. This disposition action by the Agency does not affect its interest in the NPDES and RCRA permit requirements on the facilities.



Figure 2: **Disposition Agreement**



Disposition types of privatization agreements usually involve the payment of non-operational revenues (i.e. concession, site access, host, transfer or other types of payments) from a private entity to the local government (See Figure 2). However, any type of privatization agreement that partially or totally disposes, encumbers or transfers the asset's title or other interest is a disposition agreement. This definition of a disposition agreement is used by OMB and EPA to administer Executive Order 12803 and the relevant EPA grant and property disposition regulations.

Disposition agreements were approved in June 1995 for Franklin, Ohio; May 1997 for Cranston, Rhode Island; June 1997 for Fairbanks, Alaska; November 1997 for Danbury, Connecticut; June 1998 for Wilmington,

Delaware; October 1998 for Arvin California; July 1999 for Woonsocket, Rhode Island; and October 1999 for Scranton, Pennsylvania.

The term of a disposition agreement may be affected by the presence of outstanding tax-exempt municipal debt on the wastewater treatment assets. If the local government used tax-exempt municipal bonds to finance any portion of the assets, then the term of a disposition agreement may be restricted by federal IRS tax regulations.

If the local government has no outstanding tax-exempt debt, or pays off the wastewater asset debt prior to entering into the disposition agreement, then the term can be longer because the IRS requirements do not apply. It may be possible for a local government to retire outstanding debt from available financial resources or the non-operational revenues received from the private entity. Refinancing the outstanding debt by swapping tax-exempt debt for non-operational revenue debt means the private entity has a financial interest in the wastewater assets of the local government. This refinancing approach may be beneficial to the local government if the private entity is able to guarantee lower annual wastewater treatment costs for a longer time period than could be expected under continued governmental operation and the local government is able to reduce its outstanding debt.

A disposition agreement must undergo review and approval by EPA.

Since the private entity's payment of non-operational revenues to the local government represents an investment in the facility, the private entity will need to recoup its investment plus interest through the service fees it charges to operate the facility. As a result, it is inappropriate to view a disposition agreement as a way to obtain free capital for other investments. It is, in fact, another financing source available to local governments.

A simplified example helps to illustrate this point. If a local government sells a wastewater facility for a price of \$1,000,000 and the facility has outstanding debt of \$400,000, the local government will receive net cash of \$600,000 from the sale. However, a private partner will require repayment of its total \$1,000,000 investment plus interest. So as part of the annual service fee payment, the private entity will receive repayment of the \$1,000,000 investment plus interest.

In summary, any non-operational payment a local government receives from its privatization of a wastewater infrastructure asset represents a loan from the private entity which must be repaid with interest by the wastewater treatment users in the form of additional user fees. Therefore, the value of any private entity payments which exceeds the current debt on the wastewater infrastructure represents additional debt the wastewater treatment users must repay.

If a local or state government wants to recoup all of its investment in a facility and sets a concession fee or sales price to reflect that amount, the resulting annual costs to the private entity could be very large and may result in significant increases in user fees for all the wastewater users.

EXAMPLE: DISPOSITION AGREEMENT

Facility Ownership: Local government POTW

Contract type: Operations and maintenance, plus a concession fee

Facility constructed in part with federal grants: Yes

Up-front or periodic payments from private partner: Yes

Privatization arrangement under E.O. 12803: Yes, disposition agreement

EPA review and approval: Yes—E.O. 12803 and EPA construction grant regulations—Grant deviation required

Permittee: Local government and private company may be copermittees on NPDES permit

CHAPTER 3

Factors Affecting Privatization

This section presents a discussion of the financial and non-financial factors that affect a decision to privatize. A review of these factors helps to clarify what incentives and disincentives local governments have to privatize their wastewater facilities. Financial factors address issues of cost savings, tax status of debt, capital improvements, economic risks, and local/regional economic impacts. The non-financial factors include regulatory compliance, labor, responsibility for capital improvements, municipal control, accountability, and rate stability.

Financial Factors

For any public-private partnership to be successful, a number of financial issues must be resolved to the satisfaction of all participants. Specific financial concerns including outstanding municipal debt, user fees, and the cost of private capital have important implications of privatization agreements. Each participant in the arrangement, the local, state, and federal governments and the private entity, has a different perspective on the financial structure of public-private partnerships.

Cost savings—The ability of the private sector to reduce operating costs beyond what is practically achievable by the local government is a critical factor affecting the privatization decision. Private companies reduce costs by applying their expertise to all areas of engineering, construction, operations, and maintenance.

Frequently, private companies can construct new treatment facilities at lower costs than is possible for local governments since the companies can streamline design, procurement and construction practices. Private companies may be able to apply advanced operating skills to reduce the use of chemicals and electricity in a facility while meeting or exceeding permit requirements. Private companies also may be able to lower operating costs by expertly maintaining the facility and, as a result, find it possible to operate the facility with fewer workers. In some circumstances, local governments can use the same techniques to reduce operational costs.

User fees—The attraction of lower or stable user fees over the period of the privatization contract is one of the main reasons local governments explore privatization. Often privatization will result in a reduction in user fees with a guarantee that service charges from the private entity will remain stable with increases occurring only to reflect inflation or to reflect increased costs stemming from changes in regulatory requirements, treatment processes, or facility upgrades/expansions. Contract conditions that clearly state why and how changes in service fees will occur are important to the privatization process.

Each participant
in a privatization
agreement has
a different
perspective.

Capital costs—The tax status of existing and future wastewater debt is a factor in determining the ultimate costs and benefits of any privatization agreement. The ability of the existing wastewater debt to remain tax-exempt will depend on how the specific conditions of the privatization arrangement relate to IRS tax rules. In developing a privatization agreement, the parties must carefully follow IRS tax rules to avoid changing the status of existing tax-exempt municipal bonds to taxable private activity bonds. The IRS has defined very specific types of action local governments must meet to maintain the existing tax-exempt status of municipal bonds.

When private companies must acquire capital to fund improvements to the wastewater facilities or financial contributions to the local government, the debt is usually acquired in the form of taxable private bonds. However, the IRS has defined certain limited situations where private companies can finance wastewater treatment facilities with the proceeds of tax-exempt qualified private bonds.

Even though the nominal interest rate differential between tax-exempt and taxable bonds may be significant, the actual costs of the capital may not have a great impact on the privatization decision. The private party may be able to offset the higher capital costs by the tax deductibility of interest costs and depreciation expenses.

Non-operational revenue—Up-front or periodic non-operational payments from a private entity to a local government may occur in privatization. Local governments may use these up-front or periodic payments for other infrastructure investment, refund of outstanding debt, or general tax relief under Executive Order 12803 privatization arrangements.

As discussed in the previous chapter, it is important to note that the non-operational payments are equivalent to loans from the private entity to the local government. The private entity typically recoups its investment plus interest as a part of annual service fees charged to the local government. As a result, privatization should not be viewed as a way to obtain free capital. Instead, privatization should be viewed as a potential source of capital financing for wastewater investments.

Tax-exempt status of local debt—Most local wastewater debt is in the form of tax-exempt general obligation or revenue bonds, SRF loans, and other types of bonds or loans received to build the wastewater facility. As long as the local government maintains ownership of the wastewater facility and the privatization agreement meets the conditions allowed by IRS management contracts rules, government issued debt can remain tax-exempt over the repayment term. Tax-exempt public debt is generally repaid at attractive interest rates.



Capital

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The IRS rules under “Revenue Procedure 97-13” provide additional flexibility to communities that wish to have their facilities operated under contract for an extended period of time while maintaining the tax-exempt status of their wastewater bonds. The new rules allow certain “management contracts” for “public utility property” (including wastewater treatment plants) of up to 20 years without endangering the tax-exempt status of outstanding municipal debt under certain contract arrangements.

Capital improvements- Capital improvements usually represent modifications to the wastewater facility to meet new discharge requirements, replace old infrastructure, increase efficiency, reduce operating cost, provide services to a growing residential area or meet economic growth needs by expanding the service area. Capital improvements are often costly and impose a financial burden on the local government. In privatization, depending on the terms of the privatization agreement, capital improvements may become the responsibility of the private sector. The private entity usually recovers the costs of its investment in capital improvements through the service fees paid by wastewater users. The private entity’s ability to use tax-exempt financing plus different engineering, procurement and construction practices can have a significant influence on capital improvement costs. The overall costs that result from capital improvements under privatization are important to consider when comparing the costs that would result from financing and construction under continued public ownership and operation.

Economic impacts—The local impacts will vary depending on the type of privatization agreement. Overall impacts can include potential increases in local unemployment and loss of local government control over hiring of operations personnel. Privatization has often resulted in a reduction in the staffing levels because the private firm is able to efficiently manage the facility with fewer workers. This action will potentially affect union relations, local income levels, and the local businesses that the local labor forces patronize. However, to address this concern, the private entity will frequently agree to hire most of the current employees, cooperate with labor organizations to secure job training and placement for the workers, and reduce the workforce through attrition. Frequently, the private entity has the ability to lower and stabilize wastewater rates which can contribute to the ability of the community to encourage economic growth.

Performance and liability—There are economic risks associated with meeting National Pollutant Discharge Elimination System (NPDES) permit standards and the costs resulting from unexpected wastewater flow and loading variations. When a private entity assumes operating responsibility, it assumes responsibility to meet permit limits under typical operation conditions. This responsibility usually means the private entity becomes a copermittee with the local government on the NPDES permit.

When a facility is privatized, the interests of both the local government and the private entity can be protected by defining normal operating conditions and stipulating what actions are taken to adjust service fees under different conditions, such as floods, atypical pollutant levels, or amendments to environmental regulations that increase operating costs.

Non-Financial Factors

In addition to financial factors, there are non-financial factors that affect the privatization decision. These factors include: regulatory compliance, local control, accountability, personnel impacts, responsibility for capital improvements, and the impact of state and local laws and regulations.

Regulatory compliance—When evaluating privatization, local governments must determine if private firms can operate the wastewater facility in a legal manner that maintains the facility’s publicly owned treatment works (POTW) status. This may be achieved when the local government retains ownership.

The NPDES permit status of the local government and the private operator is established by the permitting agency. However, the contract would clearly assign the performance responsibilities of the private operator. In the event of non-performance, the contract usually specifies financial penalties for the private firm. These penalties usually escalate in the event of continuing non-performance.

If all components of the facility are sold to a private entity, the facility and any industrial dischargers to the facility would be regulated under the Clean Water Act and may be subject to requirements under the Resource Conservation and Recovery Act (RCRA). The private ownership status means that industrial pretreatment requirements under the POTW status of the Clean Water Act may be replaced by RCRA requirements. In such a situation, higher treatment costs may occur if the wastewater treatment facility is designated as a RCRA hazardous waste treatment, storage or disposal facility. When an asset sale occurs, the private entity will have to apply for a new NPDES permit under its own name. The permit limits under private ownership will likely be similar to those of the previous POTW’s permit. In the Franklin, Ohio arrangement, the facility retained its POTW status by the local government retaining ownership of a portion of the wastewater treatment process under a lease arrangement. The private owner of the Fairbanks, Alaska facility will probably maintain the same NPDES permit limits, since the system does not have any hazardous waste discharges.

Local control - Under privatization agreements, the private entity controls specific operations of the facilities. However, through the privatization agreement, local governments can maintain control over important local issues such as user rates, industrial pretreatment programs, capital improvements/expansions, and modifications to the service area. Local control will vary depending on the type of privatization. When a

■
The private

partner may be a

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the NPDES permit.

local government yields ownership to the private entity, they relinquish control over the facility except in the event of a failure of the private entity to perform as required. One significant issue that may affect an asset sale is the potential for oversight from state Public Utility Commissions (PUCs). PUCs often regulate investor-owned utilities such as privately-owned public water systems. PUC oversight governs a variety of cost related activities including user rates and debt issuance. The

local government's control will be significantly reduced if the facility is subject to PUC oversight.



The level of oversight for the private entity will vary to reflect the level of concern that local governments have about the private entity's performance. Oversight activities such as local contract management, the level of performance reporting to the local government, or the use of an oversight board consisting of local authorities are negotiated as part of the privatization service agreement.

Public accountability—When a private entity operates a local wastewater facility, there may be concern or a perception that the private entity will not be as accountable as a

public operator. Communities that have opted for privatization of their wastewater facility indicate that contract requirements with specific performance levels for the private operator in all areas of operations have worked to protect the public interest and to assure a high level of accountability. All privatization agreements established with private entities need to incorporate specific performance assurances that protect the environment. Local government may require a performance bond from the private entity to add additional assurance of performance. Under an asset sale, where PUCs have jurisdiction over privately owned public wastewater facilities, the private entity would be regulated and held accountable for PUC requirements.

Personnel impacts—The private entity and local government need to consider how privatization will impact current wastewater plant personnel. Any expected reduction in staff, including the timing of the reductions and out-placement activities should be included in contract negotiations. Because of the potential for significant personnel impacts, local governments have found it important to involve workers and unions in deliberations about privatization to explore any plans for personnel adjustments including new hires, salary and budget changes, and staff reductions. Current privatization arrangements have generally used attrition or transfers as the primary way to reduce the work force.

Capital improvements—Capital improvements or wastewater capacity expansions contribute to the continued economic success of the wastewater facility. The privati-

zation agreement may address specific scheduled capital improvements during the life of the contract, including responsibility and financing arrangements. The contract negotiations define the responsibility for capital improvements and how it may vary according to the specific situations.

State laws and regulations—State laws and regulations often have significant impacts on the form and conditions of privatization agreements like the type of service, term of contract, and contracting entity. These laws and regulations vary significantly across the country but most appear to be oriented toward allowing privatization of wastewater facilities. In cases where the form of privatization desired is not explicitly allowed under state laws, local governments will find it necessary to seek the necessary legal opinions on the feasibility of the specific desired privatization arrangement.

Overall administrative complexity of the transaction—Some of the overriding issues that affect privatization are the overall complexity of designing a privatization arrangement, negotiations between public participants and the private entity, and execution of the formal contract. In cases where there are multiple facility owners or participants in a wastewater treatment system, the privatization process is likely to take a longer period of time to accomplish. In the case of extremely large regional facilities with many participating communities, the process may become so complex that it would be difficult to implement.



CHAPTER 4

Federal Requirements Affecting Privatization

Although many of the factors affecting privatization are local in nature, there are certain federal requirements that impact those decisions. IRS regulations, EPA property disposition and grant regulations, NPDES permit requirements, and Executive Order 12803 come into play in choosing the type of privatization. Some of the federal regulations restrict certain privatization activities. For example, tax law restricts the use of tax-exempt debt for privately owned facilities. Other federal requirements present a challenge because they require that local governments seek approval for changes to ownership/operation of their wastewater facilities. However, EPA's regulations apply only if the local government received EPA grants. For example, a disposition type of privatization agreement for a wastewater facility that received EPA construction grants through the Clean Water Act requires the local government to apply for a deviation from EPA's grant regulations and EPA approval under Executive Order 12803 in order to avoid implementation of EPA's property disposition regulations. Various federal requirements can potentially add additional time for the local government to complete the privatization agreement. Each of the requirements and its influence on decision-making are discussed below.

IRS Regulation/Tax Law Affecting Use of Tax-Exempt Municipal Debt

In 1986, the Tax Reform Act influenced private investment in public infrastructure by removing or limiting many tax incentives. Specifically, the amendment eliminated the investment tax credit, scaled back accelerated depreciation and limited the use of tax-exempt debt financing. These changes virtually eliminated several "lease-buy" privatization arrangements and severely restricted the duration of management contracts to five years. The main reason generally cited for these changes was that the financial incentives given to the private sector represented a very significant loss of tax revenues to the federal treasury.

As previously mentioned in Chapter 3, recently released IRS rules provide additional flexibility to communities that wish to have facilities operated under a contract arrangement without the loss of the tax-exempt status of the wastewater bonds. The new rules allow certain "management contracts" for wastewater treatment plants of up to 20 years without endangering the tax-exempt status of outstanding municipal wastewater debt. For example, a 20 year "management contract" is allowed if at least 80



percent of the compensation provided to the private partner is in the form of a periodic fixed amount. This has the effect of limiting the amount of net profit that may be provided to the private partner.

EPA Regulations and Procedures

The Clean Water Act authorized EPA to provide grant funds to local governments for the construction of wastewater treatment works. Through the Clean Water Act, local governments have received billions of dollars in federal construction grant funding to build POTWs that meet wastewater discharge permit limits established under the National Pollution Discharge Elimination System (NPDES). The NPDES requirements of the Clean Water Act establish pollutant limits for discharges from POTWs and privately owned wastewater treatment facilities.

NPDES permittee designation—NPDES regulations require that a local government obtain an NPDES permit to discharge water from its wastewater treatment facilities. Under privatization, the private operator may be a copermittee or the permittee of record. The private operator may be a copermittee with the local government on the facility's NPDES permit when the private operator is responsible for operating the entire wastewater facility under contract operations or disposition types of privatization agreements. If the facility becomes privately owned, the facility will no longer be a POTW and the private entity will be required to obtain a new NPDES or RCRA permit under its own name.

POTW designation—An important privatization consideration is the POTW status of the wastewater treatment facility. When a wastewater treatment facility loses the POTW status, it is classified as a privately owned treatment works that is no longer subject to the requirements of a municipal industrial pretreatment program. A privately owned treatment facility may also be designated as a hazardous waste treatment, storage or disposal facility under RCRA and subject to more strenuous treatment standards. Local governments and private companies have indicated that the threat of losing the POTW status has been a significant concern when evaluating privatization options.

Grant deviation procedures—EPA's regulations specify that a grantee shall not encumber its title or other interest in a wastewater asset that received grant funds. Therefore, grantees must request deviations from certain EPA regulations. The grant deviation process is used to terminate the federal interest in the assets and allow the local government to enter disposition type of privatization arrangement with a private entity.

CHAPTER 5

EPA Review of Privatization Proposals

In 1992, Executive Order 12803 established a simplified framework for privatization of facilities funded with federal grants. The order has five purposes: (1) assist local privatization initiatives; (2) remove federal barriers to privatization; (3) increase the financial incentives for state and local governments by relaxing federal repayment requirements; (4) protect the public interest by ensuring reasonable user charges; and (5) establish guarantees that the facility will continue to be used for its intended purpose.

Executive Order 12803 significantly modified the federal grant recoupment process. Under Executive Order 12803, the local and state governments are the first to receive proceeds from a disposition agreement. If the non-operational revenues received by the local government from the private entity under a disposition type of privatization agreement is greater than the state and local investment, then federal grants are repaid at their depreciated value up to a maximum of the funds received from the private entity. Federal grants are depreciated using the IRS fifteen year accelerated depreciation schedule. The Executive Order results in repayment of federal grants at a much lower level than would have resulted under EPA property disposition regulations.

When an EPA grantee decides to pursue a disposition type of privatization agreement for its POTW, the grantee will need to submit a request for a deviation from EPA's grant regulations and request EPA review and approval of the privatization arrangement under Executive Order 12803 prior to signing the privatization agreement. Several communities have undergone the EPA review and approval process to date:

Franklin, Ohio, 1995
 Cranston, Rhode Island, 1997
 Fairbanks, Alaska, 1997
 Danbury, Connecticut, 1997
 Wilmington, Delaware, 1998
 Arvin, California, 1998
 Woonsocket, Rhode Island, 1999
 Scranton, Pennsylvania, 1999

The first step in seeking EPA review and approval for a proposed disposition type of privatization agreement, prior to signing the contract with the private entity, is the submission of three copies of both the proposed privatization contract and the executive summary of the privatization agreement plus a copy of the grant deviation

Executive Order

12803 simplified

privatization of

facilities funded

with federal

grants.

request to the Agency's Director of the Office of Wastewater Management in Washington D.C. At the same time, the local government must submit a request for a grant deviation from EPA grant regulations to the applicable EPA Regional Office. The deviation request to EPA's Regional Office should include two copies of the proposed privatization agreement and the executive summary.

The decision to privatize any wastewater facilities is the sole responsibility of the local government. This decision should be based on the local government's unique financial and non-financial circumstances. The goal of EPA's review of the disposition type of privatization agreements is to facilitate the local government's decision to privatize the federally grant funded wastewater facilities.

Executive Summary

The executive summary should address the salient information that is relevant to EPA's review and approval of the privatization agreement such as: a general description of the privatization agreement, service area, permit arrangements, operational guarantees, public participation, changes in the debt structure for the wastewater facilities, amount and intended use of funds received from the private entity, grant project costs contributed by the local government, state, and EPA, the depreciation calculations for the Federal grant funds, local government's oversight responsibilities, employee status under the privatization agreement, authority for establishing future user rates, impact of the privatization agreement on user fees, and coordination with State and Federal authorities. Each of these subject areas should be supported with appropriate data. A sample executive summary is included in Appendix A. Appendix B contains a summary flow diagram of the privatization review process and a reference sheet that presents the suggested contents of an executive summary.

Privatization agreement—The general description of the privatization agreement should discuss the important objectives and clauses of the privatization contract. Some of the topics that should be included in the discussion are the contract start date, term of the contract, contract entities, amount of funds to be received by the different entities, various contract controls to assure performance or limit liability, new construction, and other significant topics. The general description should contain a discussion of the procurement process used to select the private entity and the names of other companies involved at different stages of the process.

Service area—The executive summary should describe the general physical boundaries of the wastewater system and its relationship to established political entities.



This description should present information on the population served by the wastewater facilities, number of residential households, percentage of households, commercial, industrial, and governmental users in the system, type of wastewater treatment, physical condition of the sewer system and treatment facilities, any planned or required construction, and other pertinent facts.

Permit arrangements—A discussion of the permit arrangements should address the wastewater discharge responsibilities of the various entities and their status on the NPDES or RCRA permit. The entity responsible for the various functions under the Municipal Industrial Pretreatment Program (MIPP) should be identified in this discussion. Any contract or other controls used to assure compliance with the discharge permit and MIPP should be described in general terms.

Operational Guarantees—The executive summary should describe the various operational guarantees that will be established to assure that: (1) the wastewater facilities will be operated in an effective manner to achieve compliance with the conditions of the wastewater discharge permit, (2) the industrial pretreatment standards will remain in place and enforced, (3) the facilities will be maintained in a satisfactory manner to avoid deterioration of the facility during the contract period, and (4) the facilities will continue to provide uninterrupted wastewater services in the event of contract default by the private entity. This discussion should address any monetary or other penalty that will be used to encourage compliance by the private entity.

Public Participation—A discussion of the public participation conducted by the local government to acquire support for the privatization agreement should address the number of public notices, the number and content of the public meetings, any newspaper coverage of the privatization agreement, the timing of the public discussions, the level of public participation, and any other relevant facts. A copy of the user notice describing repayment of any non-operational revenues should also be included in the executive summary.

Debt Structure—The executive summary should include a discussion of any changes in the debt structure of the wastewater facilities that will occur as a result of the privatization agreement. The discussion should describe the current debt position for the wastewater facilities and how any concession fee or transfer price will be used to reduce or eliminate existing wastewater debt.

Use of Funds—A discussion on the amount and intended use of funds received as a result of the privatization agreement should include all of the funds received from the private entity. The specific contract language or methods of payments used in the privatization agreement, or any auxiliary agreement, to convey funds to the local government is not a relevant factor in determining which funds should be addressed in the executive summary. If any funds are received by the local government from the private entity, the executive summary should identify the amount and intended

use of these funds. The value of the funds should be stated in terms of both present worth and total value.

Project Costs and Depreciation Calculations—Cost data should be included in the executive summary displaying the amounts of funds contributed by the local, state, and Federal governments for the EPA grant projects involved in the privatization agreement. The summary should include the calculations used to determine the depreciated value of the Federal grant funds using the IRS Modified Accelerated Cost Recovery System, 15 year, half-year convention schedule. The depreciated value calculations should be based on the dates the EPA grant funded projects were placed in service. A table combining the various calculations used to determine any repayment amount for Federal funds should be presented in the summary (See Appendix C).

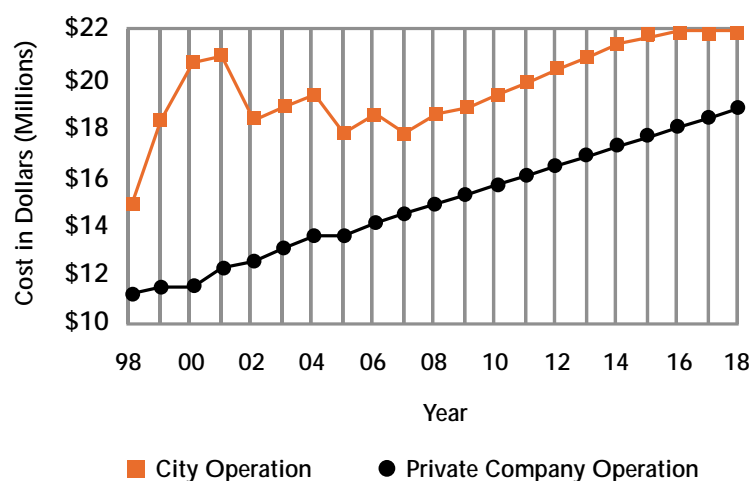
Oversight Responsibility—The executive summary should discuss the process the local government will use to administer the privatization contract to assure effective and adequate operation and maintenance of the wastewater facilities. This discussion should describe the NPDES permit, the MIPP, and the RCRA permit responsibilities that will be retained by the local government and the oversight actions the local government will use to assure that the private entity will perform the transferred responsibilities.

Employee Status—The employment status of current wastewater employees under the privatization agreement should be fully described in the executive summary. This discussion should address the local government's and private entity's personnel arrangements, including employee benefits, to assure a smooth transition of the wastewater facilities operations to the private entity.

Authority For User Rates—The entity that will be responsible for establishing and collecting the wastewater user fees should be identified in the summary. A discussion of the process used to assure adequate collection of revenues for the payment of the private entity's service fee and any other wastewater expenses should be included in the executive summary. The discussion should include the procedures that the local government will use to continue compliance with the user charge system requirements for proportional distribution of operational costs based on the actual use of the treatment services.

Impact On User Fees—The executive summary should contain information on the impact of the privatization agreement on future wastewater user fees. This information should focus on the projected user

Figure 3: **Comparison of Annual Costs**



fees to be incurred by residential wastewater users over the life of the privatization agreement. The analysis should present projected data and graphs which compare the annual and total costs of wastewater treatment under local government and private operation (See Figures 3 & 4). The data should identify the total cost savings that will result from the privatization agreement. This information should be expressed in total dollars and present worth dollars. The analysis should include data and graphs of the projected residential user costs and the projected user costs per household as a percentage of median household income (See Figures 5 & 6). The projected residential user costs should be an expression of both nominal and inflation adjusted values. The summary should contain a description of the assumptions used to calculate the projected costs.

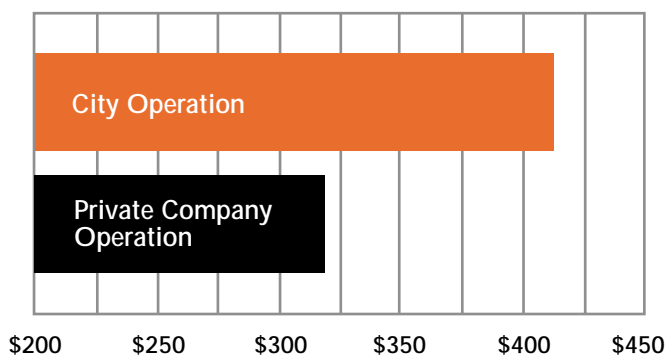
State and Federal Coordination—Any discussions the local government has had with state or Federal environmental agencies dealing with the privatization agreement, the wastewater facilities, or wastewater discharge issues should be described in the executive summary. This discussion could include such issues as construction needs for improving wastewater treatment levels, increasing capacity, combined sewer overflows, or other pertinent issues.

Executive Summary Data

Data presentation in the executive summary can be as simple as providing graphs and charts that summarize information and providing copies of pertinent information,

legal documents, public notices, and public information. For example, the graphs in Figures 3 & 4 are a simple illustration of the total costs of wastewater treatment under public operation versus private operation. The objective of any data is to clearly convey important information.

Figure 4: **Wastewater System Cost Comparison**
Cumulative Costs 1998–2018



EPA Approval of Privatization Proposals

The EPA requirements for approval of proposed disposition types of privatization arrangements focus on protection of the environment and the wastewater treatment user, compliance with the requirements of Executive Order 12803, and approving the appropriate deviations from EPA's grant regulations.

Compliance

The overriding intent of the Clean Water Act (CWA) is to improve the condition of rivers, lakes, and other water bodies by requiring that wastewater discharges meet standards for designated uses such as recreation and aquatic life support. In accordance with the CWA, EPA reviews privatization proposals for compliance with the intent of the CWA, the NPDES program, and RCRA permit requirements.

The proposed privatization agreement should contain language that addresses the process that will be followed in the event that the community wishes to expand the facility or make modifications to comply with future environmental protection requirements. The procedures for addressing a failure of the private entity to perform in accordance with the contract will be reviewed for adequate guarantees to continue wastewater services. The facility must continue to be used for its intended purpose.

The discharge permit responsibilities for each party will be reviewed to identify the penalty provisions in the event of non-compliance by the private entity. The permit responsibilities of the private entity and the local government will be established by the permitting agency. When an EPA grant funded facility is sold to a private entity, the private entity will be the sole NPDES permittee. In other disposition agreements, the private entity may be a copermitttee.

Federally-required industrial pretreatment standards are the responsibility of the local community under contract operations agreements and disposition agreements where the grantee maintains ownership. The local government must retain oversight and enforcement responsibilities for the pretreatment program. If the private entity becomes the owner, they may be required to have a RCRA permit in addition to a NPDES permit. Therefore, a privatization agreement should address the hazardous waste issue in the executive summary.

Impacts of Privatization Proposal on User Fees

Requests for approval of disposition agreements require documentation of the current and proposed user fee rate structure and arrangements for increases in the future.



The documentation of the user fee structure should include detailed information on all assumptions, data, and methods used for determining future fees. An assessment should be performed on any rate increase to determine if it is reasonable based on the specific conditions of the community. A complete analysis should take into account the Cost per Household (CPH) and Median Household Income (MHI). Other items that should be included in the user fee analysis are:

- Financial projections that show the annual revenues (user fees and other), expenses (operating and capital financing), and resulting projected costs for typical residential users. The assumptions incorporated into the projections should be included for review. Typically user fees will be computed as:

$$\frac{\text{Total Cost} \times \text{Residential Usage (\%)}}{\text{Total Households}}$$

- Graphical representation of projected user rates over the contract period using current operating conditions and the disposition agreement is a good way to communicate the effect of the privatization agreement to the public. Figure 5 provides an illustration of a projected user fee graph.
- Projected user rates per household as a percent of median household income. This information will help illustrate the effect of the privatization agreement on household affordability. It is generated with the user fee information discussed above, and the local government's MHI statistics by the U.S. Bureau of Census. Because the MHI is developed only every ten years, it will be necessary to adjust the latest MHI to current dollars before the user charge as

a percent of MHI indicator can be developed. This is accomplished by multiplying the latest MHI by an adjustment factor that reflects annual Consumer Price Index (CPI) inflation experienced nationally. The inflation adjustment factor can be found in Appendix D or developed with the following formula:

$$\text{MHI Adjustment Factor} = (1 + \text{CPI})^{\text{Current Year} - \text{Census Year}}$$

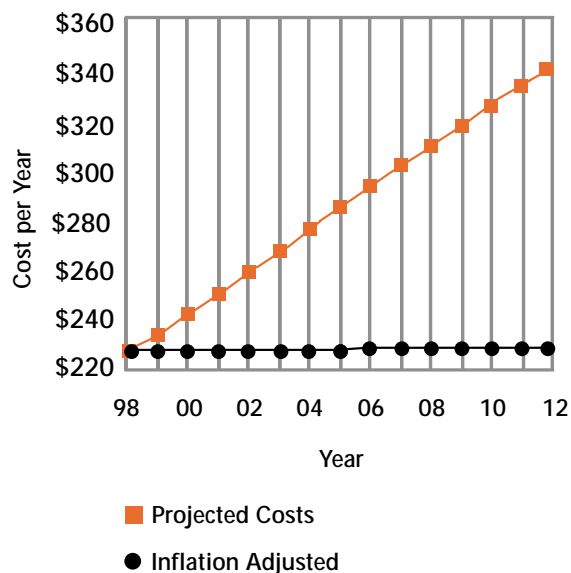
$$\text{Adjusted MHI} = \text{MHI} \times \text{Adjustment Factor}$$

A grantee's MHI is adjusted to a current level by multiplying the MHI by the adjustment factor. For example, if a permittee's MHI was \$30,000 in the 1990 census year, the average annual CPI since 1990 was 4 percent and the current year is 1992, the following calculation would be made to adjust the MHI to current dollars:

$$\text{Adjustment Factor} = (1 + .04)^{1992 - 1990} = 1.0816$$

$$\text{Adjusted MHI} = \$30,000 \times 1.0816 = \$32,448$$

Figure 5: Projected Residential Costs



So if projected user fees under the privatization agreement result in costs averaging \$350 per year the indicator would be computed as follows:

$$\begin{aligned}\text{User Fees as \% of MHI} &= \text{Projected User Fees/Adjusted MHI} \\ &= \$350/\$32,448 \\ &= 1.1\%\end{aligned}$$

It is also important to show what will happen to the affordability of user charges over time. A graph showing the projected user charges as a percent of MHI over the contract period should be included to accomplish this objective. Figure 6 illustrates this graph. Providing the public with the various types of user fee information discussed above should be a critical element in the local government's public notification efforts.

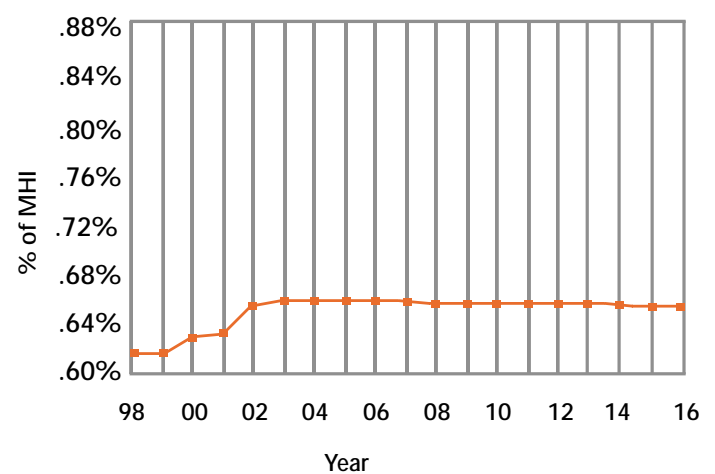
Public Participation

In the interest of protecting the rate payers, EPA will evaluate whether the grantee has provided public notices and held public meetings that presented valid estimates of wastewater rates and proposed uses of any funds received by the local government from the private entity. Documentation of public notices, public meetings, news articles, user notices and other forms of public information on the privatization agreement should be included with the Executive Summary.

Generally the number of public meetings and level of public participation will be predicated on the type and complexity of the privatization agreement. The local government is in the best position to determine the specific number of public meetings required to gain public support for the privatization agreement.

As part of the public notice process for disposition agreements, grantees should provide all users of wastewater facilities with a notice describing the repayment of any concession fees or funds provided in the privatization arrangement. The notice needs to state that a portion of the annual service fees payable by the local government out of the sewer user fees will be used to reimburse the private entity for the concession fee or other non-operating funds received by the local government (See appendix E for examples). A copy of the notice should be included in the Executive Summary of the privatization agreement submitted to EPA. Contract operation agreements do not involve such user notices.

Figure 6: Cost per Household as % of MHI
Years: 1998-2018



Compliance with E.O. 12803

In order to comply with the requirements of Executive Order 12803, EPA will review the guarantees or assurances from the grantee that the privatized facilities will be used for their original intended purpose, even in the event that the private entity becomes insolvent. EPA's review will ensure that funds acquired from a disposition agreement are used for infrastructure costs, debt reduction, or tax relief as prescribed in the Executive Order. EPA may also require that the disbursement of funds be a condition of the privatization agreement approval, fixed by local ordinance or a contract condition.

EPA will evaluate the grantee's procurement procedures for competitiveness under section 1(d) of E.O. 12803. The executive summary should describe how the proposal and award process was accomplished, describing the solicitation process (request for proposals, invitation to bidders, etc.), number of submissions, the evaluation undertaken including the criteria used to rank proposals, and the final award. The Executive Order requires that transfer prices for facilities that are disposed of through a non-competitive process rather than a competitive process be reviewed by the Office of Management and Budget. The requirement for competitive procurement is met when the grantee solicits requests for proposals and selects the most responsive private entity or entities for final negotiations. In addition,

for sale arrangements that are not accomplished through a competitive bidding process, the net asset value of the facility will need to be established through an independent third party (e.g. National Appraisers Association).

The EPA will review the reasonableness of the impact of the privatization agreement on user fees. This is accomplished by comparing the projected cost per household as a percent of MHI against accepted benchmarks of affordability. EPA guidance on the assessment of wastewater financial capability provides useful benchmarks that can be used in reviewing the affordability of proposed privatization arrangements. The benchmarks, taken from EPA's Combined Sewer Overflows-Guidance for Financial Capability Assessment and Schedule Development (EPA 832- 13-97-004) are as follows:



Financial Capability Evaluation

Annual Cost Per Household as a Percent of Median Household Income Benchmarks

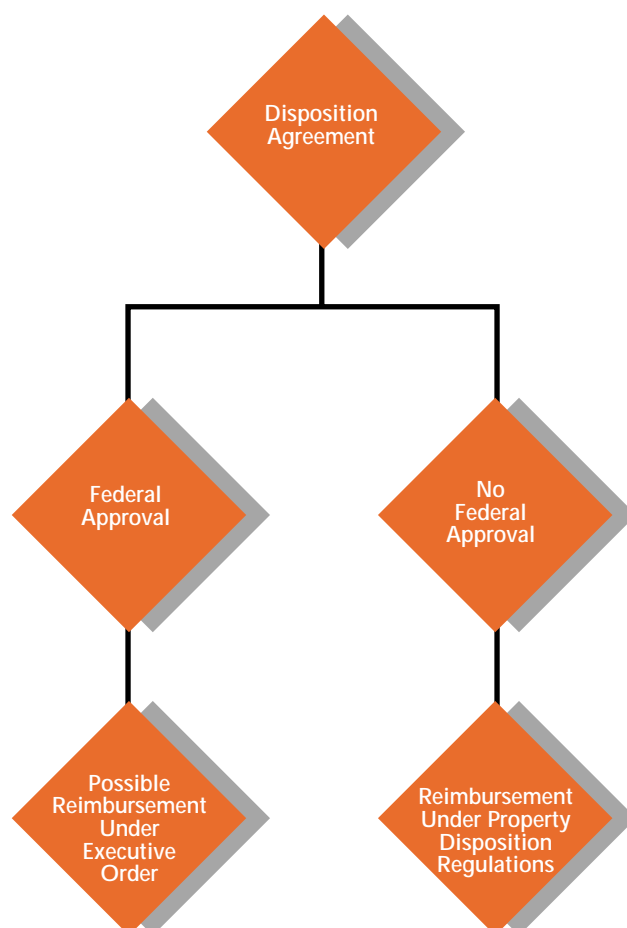
Level	Financial Impact
<1 percent	Low
1-2 percent	Mid-Range
>2 percent	High

The EPA will review the grantee's calculations for grant repayment under the Executive Order. Therefore, the executive summary should contain the federal grant history for the privatized facilities. The summary should provide the federal grant amounts, date of award, date the facility initiated service, and the amount of depreciation under IRS schedules. Appendix C contains examples of depreciation calculations, computation of Federal repayment values, and an applicable IRS schedule for 15-year property depreciation calculations under Executive Order 12803.

Grant Deviation Requirements

Executive Order 12803 simplified the process for removing the federal interest in federally funded wastewater treatment facilities when an EPA grantee wants to enter into a disposition type of privatization agreement with a private entity. The grant deviation and Executive Order 12803 approval process is the legal means used by the Agency to accomplish the action. Any wastewater facility funded with EPA grant funds will require deviations from the Agency's grant regulations and Executive Order 12803 approval prior to consummation of a disposition agreement in order to avoid implementation of EPA's property disposition regulations.

The Director of the Grants Administration Division at the Agency's headquarters in Washington, D.C. is authorized by EPA regulations to approve deviation requests from grantees to the applicable General Grant and Construction Grant Regulations. Grantees should submit their requests for deviations from the applicable grant regulations to EPA's Regional and Washington Offices. The grantee's deviation request to EPA's Regional Project Officer should include two copies of the same privatization documentation submitted to the Office of Wastewater Management in Washington, D.C. The Project Officer will forward the deviation request to the Director of Grants Administration with a recommendation on approval.



In general, grants are governed by the regulations in effect at the time of their awards. Therefore, the deviation requests would be for the applicable grant regulations that were in effect at the time of the POTW's grant awards.

Applicable general grant and construction grant regulations are presented in Appendix F. Examples of a grantee's deviation request, the Project Officer's approval letter, and the Grants Administration Division Director's approval letter are presented in Appendix G.

Disposition and Compensation Requirements

When a grantee wishes to encumber the title or other interests in its grant-funded wastewater treatment assets, the grantee basically has two options: 1) apply for prior Agency approval of its disposition agreement under the provisions of Executive Order 12803, or 2) execute the disposition agreement without prior Agency approval and comply with the requirements of the Agency's property disposition and related regulations. The first option usually provides a grantee with the most favorable circumstances for grant reimbursement due to its depreciation provision.

If a grantee, prior to executing a disposition agreement, obtains a deviation from the applicable federal grant regulations (See Appendix F) and approval of the agreement under the Executive Order, the grantee is allowed to refund a depreciated amount of the grant funds for the Federal interest in the assets.

When a grantee does not obtain deviations from the grant regulations with Agency approval of its disposition agreement pursuant to Executive Order 12803, the property disposition procedures prescribed in 40 CFR 30.800-3 (1972), 30.810-5(d)(2)(ii) (1975), 30.810-5(d)(3) (1978), 30.535(f) (1983) and 31.31(c) (1988) must be followed for determining the value of the federal interest in the grant-funded assets. Under these regulations, the federal grant funds that must be reimbursed are calculated by multiplying the total amount of non-operational revenues received by the Federal share of the project costs. To comply with the regulations, a grantee can provide a lump sum payment to the Federal government or, at the Agency's discretion, it may repay its debt in installments in accordance with 40 CFR 13.18.

Regional and State Involvement in the Privatization Process

CHAPTER 7

EPA Headquarters coordinates its review of a grantee's privatization request with EPA regional and state staffs involved with the privatization process. EPA Headquarters will contact the regional and state staffs to discuss any concerns they may have about the proposed privatization agreement during its evaluation of the arrangement. The EPA grantee should provide its state environmental agency with a copy of its privatization agreement and executive summary at the same time the data is submitted to EPA for review and approval. The EPA privatization coordinator at EPA Headquarters works to coordinate the Agency's review, approval, and grant deviation process with EPA's Regional Office and Headquarters' Grants Administration. The EPA's Regional Office usually coordinates its review with state representatives.



Appendix A

**EXECUTIVE SUMMARY
PRIVATIZATION
REQUEST FOR APPROVAL**

City of Clear Stream, California

September 1998

Note: This sample is derived from an actual executive summary submitted to EPA for review. The specific names have been changed to fictitious entities. This sample is provided as a reference source. In developing an executive summary, it is important to completely, clearly, and specifically address all of the executive summary components described in the guidance or the Executive Summary Reference sheet.

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I. REQUEST FOR APPROVAL

Due to overloading of the existing wastewater treatment facility, weather related emergencies recently encountered, and the need to provide additional treatment capacity for future growth, the City is seeking EPA approval of the 20-year wastewater operations, maintenance, construction and management Contract between the City of Clear Stream, California and New Water Operating Services.

The City of Clear Stream received a Federal Grant to expand the wastewater treatment plant on September 29, 1981, in the amount of \$2,213,363. The expanded plant was placed-in-service on June 12, 1984. Based on the placed-in-service date and using the IRS Modified Accelerated Cost Recovery System, 15-year, half-year convention schedule, the City is subject to Grant recapture in the amount of \$65,294.20 ($\$2,213,363 \times 2.95\%$ (i.e., year 16 of the 15-year MACRS table)) for the Federal grant.

II. PRIVATIZATION AGREEMENT

General Terms and Conditions

The following is a general outline of contract terms and conditions:

1. The Contract is between the City of Clear Stream, California and New Water Operating Services (NWOS), a division of New Water, a NYSE listed public company.
2. Provide financing and operations and maintenance (O&M) services over the life of the Contract and to design, permit, and construct the identified wastewater treatment plant expansion and improvements.
3. Provide wastewater treatment plant operations and maintenance (O&M) services and sewage collection system monitoring and maintenance services in accordance with this Contract and within the limits of applicable Federal, State, and City regulations, policies, and permits.
4. Provide the specified services for the 20-year period commencing immediately upon receipt of State and Federal regulatory approval.
5. Provide for reimbursement of the City's administrative costs out of the User Fees. This reimbursement is considered an operating cost. The Administration Fee designed to reimburse the City for billing, collections and administration and site easement costs.
6. Provide funds, after receipt of applicable governmental approvals, to retire the City's related contingent and other liabilities in the amount of \$850,000.
7. Provide funds, after receipt of applicable approvals, to retire the City's related debt in the amount of \$876,400.
8. Conform with applicable laws, ordinances, regulations, and policies of the United States, the State of California, the County of Summer, and the City of Clear Stream.

9. Comply with Equal Opportunity/Affirmative Action and MBE/WBE programs and local employment ordinances as required by the State of California and the City of Clear Stream.
10. Retain key personnel identified in the Proposal, with City approval required for any changes.
11. Provide insurance coverage to meet the requirements of the State of California and the City of Clear Stream.
12. Provide Performance Bond and Labor and Materials Payment Bond to protect the City of Clear Stream against performance deficiencies on the part of NWOS.
13. Provide a corporate guarantee for Contract performance, including a parent company guarantee.
14. Provide for NWOS payment of fines for any permit violations.
15. Conduct monitoring of industrial users as required under the MIPP and assist the City in administering the MIPP. The City will retain sole responsibility for adoption and enforcement of the MIPP.
16. Provides procedures for early termination.

Term of Contract

Service will be provided for a 20-year period, commencing immediately upon receipt of State and Federal regulatory approval.

III. SERVICE AREA

General Description

The City of Clear Stream is located in Summer County, California, approximately 15 miles southeast of Cookfield along State Highway 3. The City currently provides wastewater collection, conveyance, and treatment services to an estimated 11,000 residents and businesses located within the City limits. Contingent upon all required government approvals, the City has entered into an agreement with New Water Operating Services (“NWOS”) to finance, design and build an expansion to the existing wastewater treatment facility and to provide long-term contract operations and maintenance services for wastewater facilities.

The City currently owns the wastewater collection, conveyance, and treatment system that provides service within the limits of the City of Clear Stream, California. The design capacity of the existing wastewater treatment plant is 0.80 million gallons per day (mgd). However, the average annual flow to the plant has exceeded the design capacity since 1990. The average annual flow to the plant in 1997 was approximately 0.96 mgd. Average day maximum month flows to the plant have been as high as 1.17 mgd in recent years. There is a significant amount of planned growth in the City, but the City has been unable to proceed with the growth plans in the past due to inadequate capacity at the wastewater treatment plant. To meet current and future treatment needs, the existing treatment plant will be expanded to a design capacity of 2.00 mgd. The project will also include improvements and upgrades to the existing treatment facilities. The new plant is projected to be on-line, meeting effluent limits by April 30, 1999.

System User Base

As of June 30, 1998, the wastewater treatment plant system user base breaks down approximately as follows:

Single Family Residence (includes under construction)	1,978	91.8%
Multi Family Residence (includes under construction)	67	3.1%
Commercial	110	5.1%
Industrial	0	0.0%

There are a significant number of industrial users (with a significant volume of industrial Influent) that would be required to connect to the sewer system by City codes when the system is expanded to provide adequate capacity for such connections.

The majority of these potential users have repeatedly requested to be allowed to connect to the system. The proposed expansion allows for adequate capacity to serve these industrial user's needs.

Existing Wastewater Facilities

The City has owned and operated wastewater collection, conveyance, treatment, and disposal facilities since 1989. These facilities were previously owned and operated by the Clear Stream County Sanitation District.

Wastewater from City sewer customers is collected in 6 and 8-inch diameter sewers and is conveyed to the treatment plant through 10, 12, and 15-inch diameter pipes. The main interceptor sewer to the plant is 18-inches in diameter and has a calculated full-flow capacity of 3.80 mgd. A sewage pumping station was recently constructed to serve a new housing development in the City. Except for the flow contribution from the pump station, all wastewater reaches the treatment facility by gravity flow. At the present time, the system only serves customers located within the City.

The present treatment plant was constructed in 1984. The existing facility has a design flow capacity of 0.80 mgd and a peak flow capacity of 2.00 mgd. However, the average flow during July 1997 approached 1.20 mgd. Polymers are being added during high flow periods to improve solids settling in the final clarifier. Flow enters the facility via the 18- inch diameter main interceptor sewer. Preliminary treatment is provided by a comminutor and fixed bar screen that are installed in two parallel influent channels. Two screw pumps then lift the wastewater to an elevation from which it can flow by gravity through the remainder of the process units. After passing through the influent flow meter, the wastewater enters a 600,000 gallon capacity oxidation ditch to receive biological treatment. Oxygen is provided to the process by two surface aerators which include shafts, rotor assemblies, and 40 horsepower (HP) drive motors for each aerator. After passing through the oxidation ditch, the flow enters a 50-foot diameter clarifier where mixed liquor solids are settled out. The clarified effluent flows into an effluent wet well, from which the liquid can be pumped to one of two irrigation storage reservoirs. Alternatively, the water from the effluent wet-well can be pumped directly to the irrigation disposal site. An irrigation pump station is also available to transfer water from the irrigation storage reservoirs to the fields for disposal. Treated effluent from the plant is used to flood irrigate feed and fodder crops on City-owned land.

A portion of the solids that are separated from the mixed liquor in the clarifier are returned to the oxidation ditch by one of the three return sludge pumps. Excess solids are pumped to an aerated sludge holding tank where they are stored for a time before being applied to sludge drying beds. The dewatered sludge is disposed via land application.

Existing Wastewater Characteristics

Between 1989 and 1997, the average flow contribution to the City wastewater system was 89 gallons per person per day. The average influent loadings to the plant during this period were 239 milligrams per liter (mg/l) of five-day biochemical oxygen demand (BOD₅) and 218 mg/l of suspended solids (SS). Maximum month peak flows to the plant also averaged 17 percent higher than the annual average flows.

Planned Plant Expansion and Improvements to Existing Facilities

A significant amount of planned growth has been unable to proceed in the City due to inadequate capacity at the wastewater treatment plant. The City's current population of 11,000 persons is also projected to double in the next 20 years due to pent-up demand for both single family housing in the area and repeated requests for industrial connections. The existing treatment facility has been operating in excess of its design capacity since 1990 and does not have sufficient capacity to serve the current needs of the City. Additionally, the El Nino related weather problems encountered during the fiscal year 1997-1998 have had a catastrophic impact on the facility. To meet current and future treatment needs, the existing treatment plant will be expanded to a design capacity of 2.0 mgd and a peak flow capacity of 5.0 mgd. The project will also include improvements and upgrades to the existing treatment facilities.

New facilities that are needed to expand the capacity of the existing wastewater plant are summarized as follows:

1. New plant influent flow meter.
2. Mechanically cleaned bar screen and screenings press to replace the existing comminutor.
3. Influent pumps (2,000 gpm total) to provide standby capacity for the existing screw pumps.
4. Biological treatment process to augment the treatment capacity provided by the existing oxidation ditch.
5. Additional clarifier capacity to provide solids settling for the new biological treatment process.
6. Additional pumping capacity to return sludge from the new clarifier to the new biological process or waste sludge to the existing sludge holding tank.
7. A third effluent pump and additional wet-well volume to augment the capacities of the existing wet-well and two effluent pumps.
8. A second irrigation pump and wet-well to augment the capacity of the existing irrigation pump and wet-well.
9. Additional sludge drying beds (40,000 square feet) to supplement the capacity of existing drying beds at the plant.

The following upgrades and repairs to existing facilities will also be completed as part of this project.

1. Recoat/repair screw pump No.2.
2. Recoat/repair secondary clarifier mechanism.
3. Replace brush rotors and drive bearings in the existing oxidation ditch.
4. Replace scum pump No. 1 with submersible pump.
5. Replace existing emergency generator with a larger generator.
6. Add blowers, air piping, and diffuser system to the existing sludge holding tank.
7. Replace door and windows in the administration building.

IV. PERMIT ARRANGEMENTS

Ownership

In performing the Services under the Agreement, at no time shall NWOS be deemed to take title to any Influent, Effluent, Wastewater, Sewage Sludge, Reclaimed Water, Septage or other wastes or byproducts treated, processed, generated, discharged or produced at the Facility, or flowing through the Sewage Collection System, all of which items shall remain the sole property of the City.

Monitoring Requirements

NWOS shall perform all sampling, testing, and laboratory analyses of Influent and Effluent required by the WDR Permit, and the Central Valley Regional Water Quality Control Board, including a QA/QC Program (the “Existing Monitoring Requirements”). If, as the result of any Change of Law, any additional sampling, testing or analyses are required with respect to operation of the Facility (“Additional Monitoring Requirements”), NWOS shall perform the Additional Monitoring Requirements, subject to an increase in the Compensation.

Reporting Requirements

NWOS will be responsible for the following reporting requirements:

- Prepare and certify all discharge monitoring reports required under the WDR Permit. “WDR Permit” means the Waste Discharge Requirements Permit No. ZX- 145, issued by the Central Valley Regional Water Quality Control Board, pursuant to 33 U.S.C. §1342 and California Water Code §13260 et seq.
- Prepare and certify all biosolids monitoring reports required by the Summer County Biosolids Ordinance or 40 CFR Part 503 Regulations.
- Prepare and deliver, monthly or as otherwise required by Applicable Law, to the California Regional Water Quality Control Board and the U.S. E.P.A. reports discussing staffing, equipment status and emergency issues.

NWOS shall prepare and certify all discharge monitoring reports required and shall submit such reports to the City for execution and transmittal to the appropriate Government Agencies.

Effluent Specifications

The Effluent Specification shall be as follows:

Constituent	Units	30-day mean	Maximum
BOD5	Mg/l	40	N/A
TSS	MI/l	40	80

Reclaimed wastewater shall meet the disinfection and other criteria for reclaimed water used for fodder, fiber and feed crops contained in Title 22, Division 4, California Administrative Code 60309, which are incorporated herein by reference.

Performance Guarantee

NWOS shall (i) operate and maintain the Facility so as to produce Effluent meeting the Effluent Specifications; and (ii) design, construct, operate and maintain the Facility Expansion such that after completion of the Facility Expansion, the Facility has the capacity to treat Specification Influent in an amount up to the Facility Expansion Capacity and to produce Effluent meeting the Effluent Specification. See additional information on the City remedies/penalties that would be imposed should NWOS fail to meet the required performance standards at the OPERATIONAL GUARANTEES section.

Municipal Industrial Pretreatment Program

The City has adopted, does maintain and will enforce a municipal/industrial pretreatment program for the Service Area. The City is responsible to promptly amend the MIPP to incorporate any additional or modified requirements imposed under Applicable Law.

At the City's request, NWOS has agreed to conduct monitoring of industrial users as required under the MIPP and shall assist the City in administering the MIPP. At all times, the City shall retain sole responsibility for adoption and enforcement of the MIPP.

Before the City approves (1) the connection of any person who may constitute a Significant Industrial User to the Sewage Collection System; or (2) a change in the quantity, characteristics, or concentrations of wastewaters discharged by any Significant Industrial User, the City shall submit to NWOS all pertinent and requested data (including quantities and expected concentrations) concerning the proposed wastewater from the Significant Industrial User; shall confer with NWOS regarding the review and approval of such proposed action (provided that the City shall have sole decision making authority to approve or reject such proposed action). The City shall not approve any such connection or change if the wastewater to be discharged would violate the MIPP or result in Non-Specification Influent.

Due primarily to wastewater treatment plant capacity issues, City does not currently have any industrial users connected to the system. See additional information at **System User Base** in the **SERVICE AREA** section above.

V. OPERATIONAL GUARANTEES

General Requirements

NWOS shall perform the operations and maintenance (“O&M”) and construction services in accordance with Prudent Industry Practices.

NWOS will (a) operate and maintain the Facility so as to produce Effluent meeting the defined Effluent Specifications; and (b) design, construct, operate and maintain Facility expansion such that after completion of the expansion of the Facility, the Facility has the capacity to treat Specification Influent in an amount up to the Facilities proposed capacity of 5 mgd and to produce Effluent meeting the Effluent specifications. NWOS is required to provide insurance and multiple performance bonds as protection to the City should NWOS fail to perform any of their duties.

Facility Compliance with the Wastewater Discharge Permit

NWOS shall monitor the operation of the Facility and shall measure and analyze the chemical content, physical properties, volume and flow rate of Influent entering the Facility and Effluent discharged from the Facility in accordance with the Existing Monitoring Requirements. Such tests shall be conducted in compliance with the Standard Methods. Such information shall be recorded and transmitted to City upon City’s reasonable request. See additional information on the procedures to insure that the wastewater treatment facilities will be operated in an effective manner to achieve compliance with the conditions of the wastewater discharge permit at the **PERMIT ARRANGEMENTS, OVERSIGHT RESPONSIBILITY**, and **OPERATIONAL GUARANTEES** sections.

Facility Maintenance

NWOS shall implement a comprehensive preventive maintenance program to maintain the plant over the expected life of the Facility and the components thereof.

Facility Maintenance Guarantee

At the end of the contract term, NWOS shall quitclaim the Facility Site, the Facility Site Easement, Facility and Sewage Collection System to the City at no charge to the City, free and clear of any Liens relating to any financing, construction or operations by NWOS (except for those authorized or contemplated by this Agreement or otherwise approved by the City).

Insurance

NWOS shall, at its own expense, secure and maintain in effect during the Term of the Agreement the following insurance:

- Worker’s Compensation Insurance in accordance with statutory requirements and limits where applicable;
- Comprehensive General Liability Insurance that names City as an additional insured party, including contractual liability coverage for amounts of not less than \$2 million per occurrence for bodily injury and property damage; and
- Comprehensive Automobile Liability Coverage with a coverage limit of not less than \$2 million per occurrence for bodily injury and property damage.

Prior to commencing any engineering or architectural design work with respect to the Facility Expansion, NWOS or its design consultant (s) shall procure and maintain professional liability insurance or umbrella liability insurance with

limits of not less than \$1,000,000 per occurrence and not less than \$1,000,000 annual aggregate, covering errors, omissions or negligence in the performance of professional services required under this Agreement. Such professional liability insurance shall remain in full force and effect continuously for the period of design and construction of the Facility Expansion. In addition to the above required insurance policies, prior to commencing any construction of the Facility Expansion, and until the Facility Expansion Completion Date, NWOS shall procure and maintain a Builder's Risk Insurance policy and shall maintain in-force builder's risk insurance on the entire Facility. Such insurance shall be written on a completed value form and in an amount equal to \$4,400,000. Earthquake, flood and/or windstorm insurance shall be obtained if reasonably and commercially available and shall be in amounts as close to the above amounts as is reasonably and commercially available. The insurance shall apply on a replacement cost basis.

Proof of Insurance

NWOS shall provide City certificates evidencing proof of such insurance. In the event that the required insurance coverage is canceled or cannot be obtained, NWOS will notify City within thirty (30) days.

Performance and Payment Bonds

- During the term of the Agreement, NWOS shall maintain a performance and payment bond ("Performance and Payment Bond") in an amount equal to the anticipated amount of User Fees for a one-year period (as reasonably approved by NWOS and the City), escalated annually according to the Adjustment Escalator, securing faithful performance by NWOS of its obligations under this Agreement with respect to operation, maintenance, repair and replacement of the Facility and the payment by NWOS to compensate subcontractors and suppliers of work and materials in the operations, maintenance, repair and replacement of the Facility.
- Contemporaneous with the commencement of construction of the Facility Expansion, NWOS shall deliver to the City a construction performance and payment bond (Construction Performance and Payment Bond) payable to the City in an amount equal to one-hundred and ten percent (110%) of the construction cost of the Facility Expansion (as reasonably approved by NWOS and the City), securing faithful performance by NWOS of its obligations under this Agreement with respect to the design, construction, shakedown, and testing of the Facility Expansion and the payment by NWOS to compensate subcontractors and suppliers for work or materials used in construction of the Facility. Such construction performance and payment bond shall remain in effect until the Facility Expansion Construction Completion Date.

VI. PROCUREMENT PROCESS / PUBLIC PARTICIPATION

Competitive Bid

The bid was awarded through a competitive bidding process based on a Requests for Proposals ("RFP") issued May 18, 1998. As required by law, the RFP was announced in two (2) daily publications: The Cookfield Californian and The Clear Stream Times.

The procurement process and Contracts comply with appropriate laws, ordinances, and regulations of the Federal Government, the State of California, and the City of Clear Stream.

Basis of Procurement

Pursuant to California Government Code §5956.1 et seq., the City engaged in a competitive bidding process for the procurement of engineering, design, financing, construction, operation and maintenance services with respect to the Facility. Pursuant to such a competitive bidding process, the City selected NWOS as the contractor to provide such services with respect to the Facility.

It is the understanding of the City of Clear Stream and NWOS that this Agreement shall be treated as and constitute a service contract pursuant to Section 7701(e) of the Internal Revenue Code, Treasury Regulation Section 1.141-3(b)(4) and Revenue Procedure 97-13.

City Rights and Disclaimers for RFP Process

As part of the RFP, the City maintained all rights to investigate the qualifications of any of the bidders under consideration (including proposed subcontractors and parties otherwise related to the Proposer), require written confirmation of information furnished by any bidder (to be provided within 5 working days), or require additional evidence of experience and qualifications to provide the services or otherwise discharge the obligations required by the RFP.

The RFP did not commit the City to enter into a Contract, nor did it obligate the City under any circumstances to pay for any costs incurred in the preparation and submission of Proposals; for site visits, demonstrations, interviews; for the preparation of responses to questions and requests for additional information; for Contract discussions; or for anything in any way related to this RFP. In submitting a Proposal, the Bidder (including all related parties) disclaimed and voluntarily and knowingly waived any and all rights to reimbursement for any such costs.

Submittal of Proposals / Public Inspection

At the opening of the Bids, the City prepared a list of Bidders(Appendix A(not included)) which included the name of each Bidder and the date and time the proposal was received. This list was open for public inspection at City Hall. Proposals were not available for public inspection.

City Council Meetings / Open Forum for Public Comments

Each step of the RFP and final Bid award process was discussed and open for public comment in the monthly City Council meetings. In general, the public was very supportive of the privatization. See attached copy of the articles and editorials out of the local newspaper: *The Cookfield Californian* (Appendix B (not included)). As with most items on the political agenda in the City of Clear Stream, public participation was light even with advanced public notice of the numerous public meetings on the privatization activities. A summary of the public meetings is presented in Appendix B (not included).

Basis of Award

The award was based primarily on the demonstrated competence and qualifications of the entities submitting the award and the overall cost to the citizens of the City of Clear Stream.

Newspaper Coverage

The local newspaper, *The Cookfield Californian*, provided very favorable coverage of the privatization process. Attached at Appendix B(not included), please see various newspaper articles and editorials.

Notice to Rate Payers

A proposed notice which the city will send to all users of the wastewater system is presented in Appendix D (*not included*). This notice explains how the funds received by the City from NWOS will be repaid to NWOS as part of the annual service fee to NWOS. The notice will be sent to the users as soon as the city's proposed privatization agreement with NWOS has been approved by the EPA.

VII. DEBT STRUCTURE

As part of the Privatization, NWOS will provide the City of Clear Stream funds to retire all current wastewater treatment plant related debt (i.e. bonds) and other related liabilities. The current bond principal outstanding balance of \$876,400, represents the remaining debt incurred as a result of the previous wastewater treatment plant expansion. See additional information at **USE OF FUNDS**.

VIII. USE OF FUNDS

As soon as reasonably possible after the City of Clear Stream obtains CEQA approval, all State of California approvals, and EPA approvals, NWOS will pay to the City of Clear Stream \$1,726,400, which represents the funds necessary to pay all outstanding wastewater treatment plant (WWTP) related liabilities. The total liabilities consist of accounts payable and accrued liabilities of \$850,000 and Bonds Payable (debt) of \$876,400.

Accounts Payable and Accrued Liabilities related to the City of Clear Stream WWTP break down approximately as follows:

Land Acquisition - land required for effluent disposal	\$262,000
Employee Liabilities - Resulting from termination of employees prior to rehire by NWOS	40,000
Professional Fees - legal, accounting, and advisory fees related to the privatization of the WWTP	225,000
Engineering and Design Fees - fees incurred by the City of Clear Stream related to the pending WWTP expansion	167,000
Reimburse the City's General Fund Construction Costs Advanced by that Fund- Costs incurred to build a new settling pond and to install an effluent disposal line (to the land described above)	156,000
Total Accounts Payable & Accrued Liabilities	\$850,000

The Bond principal outstanding of \$876,400, represents the remaining portion of debt incurred as a result of the previous WWTP expansion.

The payment is included in NWOS capital costs for the pending Plant expansion. The Capital Costs will be amortized over the life of the agreement. The present value of the initial payment from NWOS to the City of Clear Stream is \$1,726,400, as the full payment is made immediately upon receipt of all applicable approvals.

IX. PROJECT COSTS AND DEPRECIATION CALCULATIONS

Projected Capital Costs for the Proposed Expansion

The planned City of Clear Stream Wastewater Treatment Plant Expansion and Improvement Project Capital Costs are calculated as follows:

Payment to the City of Clear Stream to retire WWTP related Debt and other Liabilities (See additional information at USE OF FUNDS and DEBT STRUCTURE, above).	\$1,726,400
NWOS projected capital costs (based on a fixed, not-to-exceed bid)	4,237,160
Total Capital Costs for Proposed Expansion	\$5,963,560

These costs will be financed fully by NWOS.

The fixed, not-to-exceed bid for the capital costs related to the planned expansion was a key factor in the selection of NWOS as the winning bidder from the RFP process. Prior engineering estimates for the proposed expansion were in excess of \$5.2 million, without paying off the \$1,726,400 of related Debt (bonds) and other liabilities.

Recapture of Federal and State Grant Funds

The City of Clear Stream received a Federal Grant to expand the wastewater treatment plant on September 29, 1981, in the amount of \$2,213,363. The expanded plant was placed-in-service on June 12, 1984. Following is a schedule of the relative contributions for the previous expansion:

Federal Grant	\$2,213,363	61%
State Grant	\$368,894	10%
City of Clear Stream	\$1,042,400	29%
Total	\$3,624,657	100%

Based on the placed-in-service date and using the IRS Modified Accelerated Cost Recovery System (MACRS), 15-year, half-year convention schedule, the City is subject to Grant recapture in the amount of \$65,294.20 (\$2,213,363 x 2.95% (i.e., year 16 of the 15-year MACRS table)) for the Federal grant. The City of Clear Stream financed their portion of the plant cost with 1933 Act Bonds.

X. OVERSIGHT RESPONSIBILITY

Oversight will be accomplished through a combination of Reporting Requirements, Performance Testing and Monitoring, and Governmental Approvals. Following are outlines of each.

Reporting Requirements

NWOS will be responsible for preparing and certifying the following governmental reports:

- Prepare and certify all discharge monitoring reports required under the WDR Permit.
- Prepare and certify all biosolids monitoring reports required by the Summer County Biosolids Ordinance or 40 CFR Part 503 Regulations.
- Prepare and deliver, monthly or as otherwise required by Applicable Law, to the California Regional Water Quality Control Board and the U.S. E.P.A. reports discussing staffing, equipment status and emergency issues.
- Conduct monitoring of industrial users as required under the MIPP and report instances of non-compliance to the City.
- The City will retain sole responsibility for adoption and enforcement of the MIPP.

These reports will be submitted to the City for review, execution and transmittal to the appropriate government agencies.

NWOS will also be responsible for preparing a Monthly Operations Report to the City of Clear Stream.

NWOS will be responsible to annually prepare and deliver, within thirty (30) days of the end of the City's fiscal year, a report summarizing significant events and accomplishments over the past year and any planned activities and recommended capital improvements for the current year.

Performance Testing and Monitoring

Compliance testing for BOD5 will be conducted at a certified outside laboratory using standard method 5210 (EPA 405.1). In addition, an outside laboratory will also perform the annual sludge testing. These tests include metals (As, Cd, Cr, Cu, Pb, Hg, Mb, Ni, Se, Zn), Total Nitrogen, and Fecal Coliform.

City Engineer

The City has a consulting engineer who has the ability to and will assist with the review and approval of all reporting from NWOS. The key services to be provided by the City Engineer are an annual inspection of the facility and assisting in the resolution of issues that arise between NWOS and the City.

Compliance monitoring for settleable matter, total suspended matter, dissolved oxygen, total solids (sludge) and electrical conductivity will be conducted by NWOS with reports provided to the City for review.

Permits / Governmental Approvals

NWOS shall prepare all applications and supporting information required for all Governmental Approvals required under Applicable Laws for the design, construction, testing, operation and maintenance of the Facility Expansion. Except for those Governmental Approvals which must be held by NWOS pursuant to Applicable Law, City shall execute and submit all such Governmental Approval applications and shall obtain all such Governmental Approvals to be held in the name of City. NWOS and City shall be copermittees on any Governmental Approvals to the extent required by Applicable Law. NWOS shall apply for and obtain any Governmental Approvals which NWOS is obligated to hold directly as a contractor providing the Services set forth in this Agreement.

XI. EMPLOYEE STATUS

General Description

The City has owned and operated the wastewater collection, conveyance, treatment, and disposal facilities since 1989. These facilities were previously owned and operated by the Clear Stream County Sanitation District. NWOS will hire the existing plant employees to assure a smooth transition of the wastewater facilities and to provide the terminated City employees with enhanced employment opportunities. NWOS will provide qualified management, supervisory, technical, laboratory, and operating personnel with licenses as required by the rules, regulations, and policies set by the State of California, the United States Environmental Protection Agency (USEPA) and any other applicable government agency(s). This will include a manager for day-to-day supervision, sufficient operating personnel to run the plant, specialists in quality control, instrumentation, troubleshooting, and emergency management as may be necessary, and office and clerical support staff. NWOS will also provide technical support, as necessary, to provide on-call backup advice, expertise and quality control, management, maintenance and plant repair to assist the operational staff and ensure performance of obligations hereunder and to design and construct any new improvements to the system. By hiring the current plant employees and combining them with other NWOS resources, NWOS is able to provide a staff of qualified and experienced employees who have direct experience in operating, maintaining and managing the City's wastewater system as well as experience in operating plants similar in nature and character to the Clear Stream system and shall provide such additional third-party support as may be needed to perform its duties and obligations.

NWOS will offer employment to the two current City of Clear Stream Wastewater Treatment Plant Operators. Such operators will be provided with a salary and benefits which have a total monetary value equivalent to the salary and benefits currently provided to such operators by the City. These employees will become NWOS employees and shall no longer be employees of the City. A portion of the initial payment from NWOS to the City will be used to fully fund the terminated employees pension and other benefits for a period of time required for NWOS to provide comparable benefits (at a minimum). See additional information at **USE OF FUNDS**.

XII. AUTHORITY FOR USER RATES

General

The City has the sole responsibility to establish, maintain, and collect all sewer service fees, charges and assessments, connection charges, assessments and fees and water treatment charges, assessments and fees (collectively "User Fees"). The agreement provides for City Council (City) to have control of User Fees and provides a mechanism to enforce collections of the applicable User Fees (through property tax liens and building permit issuance and enforcement).

If the User Fees collected are insufficient to pay the required compensation to NWOS and other required expenditures, the City is contractually required, to the extent permitted by all applicable laws, to increase User Fees sufficiently to pay NWOS' contractual compensation, reimbursement of the City's administrative costs and other wastewater treatment related expenditures. The City will contractually not be allowed to discount, waive, reduce, reallocate or defer any user fees unless there is prior approval from NWOS.

All User Fees and other revenue or income derived by the City from the use and operation of the Facility and the Sewage collection system must be dedicated, in accordance with California Government Code 5956.6 and other applic-

able laws, exclusively for the payment of the direct and indirect capital costs, the direct and indirect operating and maintenance costs for the sewage collection system and the Plant, the direct and indirect administration and overhead, and NWOS' return on investment.

Proportional User Charges

As required in the Federal Grant regulations contained in the Grant Agreement, the City will continue to proportionally distribute the wastewater treatment costs among the user base.

XIII. IMPACT ON USER FEES

General

The City's privatization goals are to improve the efficiency and effectiveness of operation and maintenance services; improve and maintain the performance of the current wastewater treatment system to meet appropriate standards and permit requirements; and to limit the economic exposure of City residents via long-term, stable sewer rates.

Pre-Facility Expansion Monthly Fee

Effective on the Contract Date and until the Facility Expansion Completion Date, City shall pay to NWOS a monthly fee of \$41,500 (the "Base Monthly Rate"), escalated annually on May 1 of each year beginning on May 1, 1999, pursuant to the Adjustment Escalator (see below).

Post-Facility Expansion Service Fee

Starting in the first calendar month following the Facility Expansion Completion Date, City shall pay to NWOS a monthly service fee (the "Service Fee") equal to the sum of (1) 1/12th of the ***NWOS Recovery of Capital*** (see below), (2) 1/12th of the ***Fixed Component of the Service Fee*** (see below), and (3) an amount equal to the ***Fixed Component of the Service Fee*** (see below) multiplied by the volume of Influent entering the Facility during the Billing Period.

NWOS Recovery of Capital

The annual NWOS recovery of capital charge ("NWOS Recovery of Capital"), representing the aggregate amortized cost (including interest thereon) of NWOS's (i) funding of the repayment and redemption of the Existing Debt and (ii) investment in, and the costs incurred by NWOS in connection with the financing for, the Facility Expansion (including the fee for land costs and consulting services set forth in Section 7.7), is \$386,000 per year (or \$32,167 per month). The NWOS Recovery of Capital shall not be escalated by the Adjustment Factor. However, the NWOS Recovery of Capital may be increased as provided in Section 7.5(a) for the cost of design changes to the Facility Expansion or for amounts of Existing Debt in excess of \$876,400 that NWOS elects to repay and redeem; and as provided in Section 7.5(b) for NWOS-Financed Capital Projects.

Fixed Component of the Service Fee

The fixed component of the Service Fee ("Fixed Component"), which includes payment for NWOS's fixed operation and maintenance expenses, reimbursement of the City's administrative costs and other fixed costs, shall be \$621,219 per year (\$51,768.25 per month), adjusted annually on each Facility Expansion Anniversary Date pursuant to the Adjustment Escalator (see ***CPI Adjustment Escalator***, below).

Variable Component of the Service Fee

The variable component of the Service Fee (“Variable Charge”) shall be based on the volume of Influent entering the Facility at the Point of Delivery in each Billing Period multiplied by the rate of \$0.311 per 1000 gallons (the “Variable Rate”) of Influent delivered to the Point of Delivery, adjusted annually beginning on the Facility Expansion Anniversary Date pursuant to the Adjustment Escalator as determined pursuant to Section 7.3; provided, however, that the Variable Rate shall be increased to \$3.00 per 1000 gallons of Influent delivered to the Point of Delivery in excess of 1.20 million gpd, adjusted annually beginning on the Facility Expansion Anniversary Date pursuant to the Adjustment Escalator as determined pursuant to Section 7.3.

CPI Adjustment Escalator

The Adjustment Escalator shall be determined in accordance with the U.S. Department of Labor, Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers Los Angeles- Anaheim-Riverside (all items) on the basis of 1982-84 = 100 (“CPI”). If the CPI is discontinued or substantially modified, the parties shall mutually select another substantially equivalent index for the purpose of price escalation or deflation. In no event shall an ***Adjustment Escalator*** of less than **0%** be used.

Restrictions Under Applicable Law

If the present or future interpretation or the future imposition of any Applicable Law shall prevent NWOS from increasing the price or revising the price as herein provided, or shall nullify or reduce said price specified herein, NWOS and City shall promptly meet to determine if mutually agreeable changes can be made in this Agreement to cause it to conform with such Applicable Law. If mutually agreeable changes cannot be effected within sixty (60) days after such meeting, NWOS shall have the right to have the issue resolved in accordance with the procedures set forth in Section 16.5.

Wastewater System Cost Comparisons

A comparison of the Net Present Value (NPV) of operating costs over the 20 years of the contract are as follows:

Operator	NPV of Operations Costs
NWOS	\$38,260,455
City Operation	\$41,602,861
\$ Difference NWOS vs. City Operation	(\$3,342,406)
% Difference NWOS vs. City Operation	(8.7%)

The key difference between NWOS as the operator of the Facility and a City run operation, is that NWOS costs are “guaranteed”, but the City run operation costs could increase significantly (i.e., the operating costs of a City run operation could be greater than the projected costs).

User Fees as a % of Median Household Income

User Fees as a % of Median Household Income (MHI), which was calculated using an inflation adjusted MHI figure from the 1990 census:

Description	Calculation
Cost per Household per year*	\$319
Adjusted MHI	\$26,389
User Fees as a % of MHI	1.20%

* The User Fees are \$319 prior to the privatization and will remain \$319 after the privatization. Connection Fees and a gross increase in User Fees (from the projected increase in the number of users) resulting from the high growth in the City will make up the increase in the post facility expansion fee payable to NWOS. Based on the current projections, an increase in the User Fees is not expected to be required for 8 to 10 years.

Financial Capability Evaluation

The Financial Impact is in the lower portion of the “Mid-Range”. The main reason is that there is a high level of poverty due to the lack of an adequate economic base. The City of Clear Stream / NWOS contract contains a CPI index clause only based on this. The financial impact is expected to remain constant if there is 0% growth in the economic base of the City. It is, however, expected that the expansion of the facility should allow the City to expand its economic base, which would increase the MHI and decrease the financial impact to a “Low” impact.

XIV. STATE AND LOCAL COORDINATION

General

The design capacity of the existing wastewater treatment plant is 0.80 million gallons per day (mgd). However, the average annual flow to the plant has exceeded the design capacity since 1990. The average annual flow to the plant in 1997 was approximately 0.96 mgd. Average day maximum month flows to the plant have been as high as 1.17 mgd in recent years. There is a significant amount of demand for growth in the City but the City has been unable to accommodate the growth due to inadequate capacity at the wastewater treatment plant. Additionally, the El Nino related weather problems encountered during the fiscal year 1997-1998 have had a catastrophic impact on the facility. To meet current and future treatment needs, the existing treatment plant will be upgraded and expanded to a design capacity of 2.00 mgd.

The goals of the City in procuring private sector services are to improve the efficiency and effectiveness of operation and maintenance services; improve and maintain the performance of the wastewater treatment system to meet appropriate standards and permit requirements; and to limit the economic exposure of City residents via long-term, stable sewer rates.

State Regional Water Quality Control Board

As stated above, the average annual flow to the plant has exceeded the design capacity since 1990, but to date, the City has been unable to raise the funds necessary to execute a plant expansion. This has been a great concern to the California State Regional Water Quality Control Board (RWQCB) for the last eight (8) years. Personnel from the City of Clear Stream and NWOS have had multiple meetings with officials and staff of the RWQCB. The RWQCB is supportive of the proposed privatization in part because the required expansion will finally be executed. The RWQCB has officially approved the privatization transaction and NWOS’ design for the expansion of the Facility.

CEQA Approval

The City was solely responsible for the preparation and the completion of all notifications, studies, reports, analyses (including any environmental assessment, finding of no significant impact, or environmental impact report), compliance with the other procedures of, and procurement of all approvals required under the California Environmental Quality Act, California Public Resources Code 21000 et seq., and the regulations adopted pursuant thereto (the “CEQA Approval”). Prior to the City’s decision to privatize the wastewater treatment operations of the City, CEQA approval was obtained for a proposed facility expansion design that would have been built and operated by the City (with the assistance of outside engineers and contractors). The change to a privatized operation and an alternate facility expansion design required the City to resubmit the request for CEQA approval. The revised request was changed relatively little from the original request. Verbal CEQA approval has been received. The official CEQA approval is expected to be received during the week of August 10, 1998.

EPA Approval

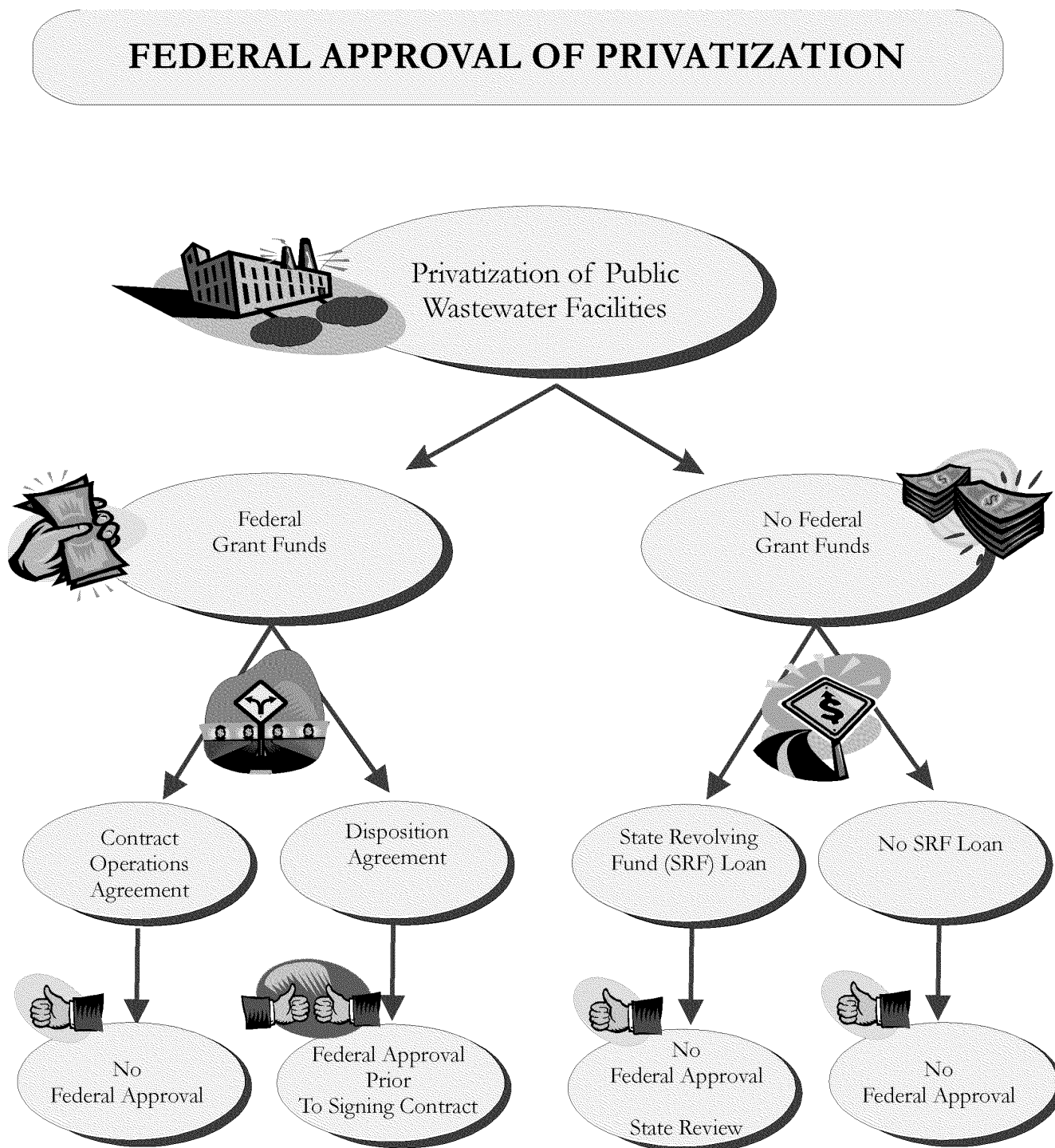
Due to overloading of the existing wastewater treatment facility, weather related emergencies recently encountered, and the need to provide additional treatment capacity for future growth, the City of Clear Stream is requesting an approval of the privatization transaction from the EPA.

Termination Clause

If EPA approval is denied for any reason, the contract negotiations would be terminated based on an “Uncontrolled Circumstance.” Section 2.2 (c) of the Contract requires the City to get all required approvals, including that of the EPA. Section 14.1 of the Contract defines an “Uncontrolled Circumstance.” As per Section 14.3, the City and/or NWOS has the right to terminate for a continuing “Uncontrolled Circumstance.”

Appendix B

Summary Flow Diagram of the Privatization Review Process



Executive Summary Reference Sheet

Section	Contents
1. Privatization Agreement	<ul style="list-style-type: none"> • General description of the agreement • Contract start date • Term of the contract • Contract entities • Amount of funds • New construction • Contract controls • Procurement process • Basis of award
2. Service Area	<ul style="list-style-type: none"> • General description of the system's physical boundaries • System user base data • Wastewater treatment • Planned plant expansion and improvements to existing facilities
3. Permit Arrangements	<ul style="list-style-type: none"> • Ownership • Permit responsibilities • Reporting responsibilities • Performance guarantee • Municipal Industrial Pretreatment Program
4. Operational Guarantees	<ul style="list-style-type: none"> • General requirements • Facility compliance with the wastewater discharge permit • Facility maintenance • Insurance • Performance and payment bonds • Penalties
5. Public Participation	<ul style="list-style-type: none"> • Public notice/hearings • Public participation • RFP process • Proposals/public inspection • Newspaper coverage • Notice to rate payers

6. Debt Structure

- Changes in the wastewater facilities' debt structure
- Current debt position
- Effect of concession fee or transfer price

7. Use of Funds

- Description of amount and use of non-operational funds
- Value of funds in present worth and total value

8. Project Costs and Depreciation Calculations

- Amount and sources of funds used to construct facilities
- Repayment of federal and state grant funds

9. Oversight Responsibility

- Contract administration
- Reporting requirements
- Permit responsibility

10. Employee Status

- General description
- Employee benefits

11. Authority for User Rates

- General description
- Responsibility for sufficient revenues
- Proportional user charges

12. Impact on User Fees

- General description
- Pre-contract fees
- Post-contract fees
- Recovery of capital
- Contract savings
- CPI adjustment escalator
- Wastewater system cost comparisons
- User fees as a % of median household income
- Financial capability evaluation
- Description of cost calculation assumptions

13. State and Federal Coordinating

- General description of discussions with federal and state agencies
- Construction needs

Appendix C

Federal Grant Repayment For the Sale/Lease of Wastewater Treatment Facilities

EPA Construction Grants		
Award Date	Placed in Service	Amount
6/04/73	7/19/76	\$5,971,074
10/29/74	1/31/76	\$8,863,868
9/21/83	12/28/84	\$1,952,370
Total		\$16,787,312

Local Costs for 1973 Project	\$1,238,220
Local Costs for 1974	\$1,134,270
Local Costs for 1983 Projects	\$220,450
TOTAL Local Costs	\$2,692,940

Type of Privatization	Sale	Lease
Accounting Value of Wastewater Facilities	\$2,500,000	NA
Concession Fee (Lease)	\$0	\$2,000,000
Transfer Price Wastewater Facilities (Present Value of Sale Fee)	\$5,000,000	\$0
Less Total Local Costs	\$2,692,940	\$2,692,940
Less State Cost Repayment	\$0	\$0
Residual Value of Sale/Lease Fee (Concession/Sale Fee - Local & State Costs)	\$2,307,060	(\$692,940)
Depreciated Value of EPA Grants	\$288,170	\$288,170
Amount City Owes Federal Treasury	\$288,170	\$0

**Depreciation Schedule for \$1,952,370 Grant
Placed in Service 12/28/84 (MARCS) and a 1996 Transaction Date**

1984	.05	97,618.50	1,854,751.50
1985	.095	185,475.15	1,669,276.35
1986	.0855	166,927.63	1,502,348.72
1987	.077	150,332.49	1,352,016.23
1988	.0693	135,299.24	1,216,716.99
1989	.0623	121,632.65	1,095,084.34
1990	.0590	115,189.83	979,894.51
1991	.0590	115,189.83	864,704.60
1992	.0591	115,385.06	749,319.62
1993	.0590	115,189.83	634,129.79
1994	.0591	115,385.06	518,744.73
1995	.0590	115,189.83	403,554.90
1996	.0591	115,385.06	288,169.84

Note: EPA grants placed in service during 1976 or earlier are fully depreciated using MARCS, 15 year, half-year convention schedule.

**Internal Revenue Service Table A-1 Depreciation for 15- year Property
Half-Year Convention**

Depreciation Rate for Recovery Period

Year	15-year
1	5.00%
2	9.5
3	8.55
4	7.7
5	6.93
6	6.23
7	5.9
8	5.9
9	5.91
10	5.9
11	5.91
12	5.9
13	5.91
14	5.9
15	5.91
16	2.95

Appendix D

MHI ADJUSTMENT VALUES

R a t e																		
Year	0.005	0.01	0.015	0.02	0.025	0.03	0.035	0.04	0.045	0.05	0.055	0.06	0.065	0.07	0.075	0.08	0.085	0.09
1	1.0050	1.0100	1.0150	1.0200	1.0250	1.0300	1.0350	1.0400	1.0450	1.0500	1.0550	1.0600	1.0650	1.0700	1.0750	1.0800	1.0850	1.0900
2	1.0100	1.0210	1.0302	1.0404	1.0506	1.0609	1.0712	1.0816	1.0920	1.1025	1.1130	1.1236	1.1342	1.1449	1.1556	1.1664	1.1772	1.1881
3	1.0151	1.0303	1.0457	1.0612	1.0769	1.0927	1.1087	1.1249	1.1412	1.1576	1.1742	1.1910	1.2079	1.2250	1.2423	1.2597	1.2773	1.2950
4	1.0202	1.0406	1.0614	1.0824	1.1038	1.1255	1.1475	1.1699	1.1925	1.2155	1.2388	1.2625	1.2865	1.3108	1.3355	1.3605	1.3859	1.4116
5	1.0253	1.0510	1.0773	1.1041	1.1314	1.1593	1.1877	1.2167	1.2462	1.2763	1.3070	1.3382	1.3701	1.4026	1.4356	1.4693	1.5037	1.5386
6	1.0304	1.0615	1.0934	1.1262	1.1597	1.1941	1.2293	1.2653	1.3023	1.3401	1.3788	1.4185	1.4591	1.5007	1.5433	1.5869	1.6315	1.6771
7	1.0355	1.0721	1.1098	1.1487	1.1887	1.2299	1.2723	1.3159	1.3609	1.4071	1.4547	1.5036	1.5540	1.6058	1.6590	1.7138	1.7701	1.8280
8	1.0407	1.0829	1.1265	1.1717	1.2184	1.2668	1.3168	1.3686	1.4221	1.4775	1.5347	1.5938	1.6550	1.7182	1.7835	1.8509	1.9206	1.9926
9	1.0459	1.0937	1.1434	1.1951	1.2489	1.3048	1.3629	1.4233	1.4861	1.5513	1.6191	1.6895	1.7626	1.8385	1.9172	1.9990	2.0839	2.1719
10	1.0511	1.1046	1.1605	1.2190	1.2801	1.3439	1.4106	1.4802	1.5530	1.6289	1.7081	1.7908	1.8771	1.9672	2.0610	2.1589	2.2610	2.3674
11	1.0564	1.1157	1.1779	1.2434	1.3121	1.3842	1.4600	1.5395	1.6229	1.7103	1.8021	1.8983	1.9992	2.1049	2.2156	2.3316	2.4532	2.5804
12	1.0617	1.1268	1.1956	1.2682	1.3449	1.4258	1.5111	1.6010	1.6959	1.7959	1.9012	2.0122	2.1291	2.2522	2.3818	2.5182	2.6617	2.8127
13	1.0670	1.1381	1.2136	1.2936	1.3785	1.4685	1.5640	1.6651	1.7722	1.8856	2.0058	2.1329	2.2675	2.4098	2.5604	2.7196	2.8879	3.0658
14	1.0723	1.1495	1.2318	1.3195	1.4130	1.5126	1.6187	1.7317	1.8519	1.9799	2.1161	2.2609	2.4149	2.5785	2.7524	2.9372	3.1334	3.3417
15	1.0777	1.1610	1.2502	1.3459	1.4483	1.5580	1.6753	1.8009	1.9353	2.0789	2.2325	2.3966	2.5718	2.7590	2.9589	3.1722	3.3997	3.6425
16	1.0831	1.1726	1.2690	1.3728	1.4845	1.6047	1.7340	1.8730	2.0224	2.1829	2.3553	2.5404	2.7390	2.9522	3.1808	3.4259	3.6887	3.9703
17	1.0885	1.1843	1.2880	1.4002	1.5216	1.6528	1.7947	1.9479	2.1134	2.2920	2.4848	2.6928	2.9170	3.1588	3.4194	3.7000	4.0023	4.3276
18	1.0939	1.1961	1.3073	1.4282	1.5597	1.7024	1.8575	2.0258	2.2085	2.4066	2.6215	2.8543	3.1067	3.3799	3.6758	3.9960	4.3425	4.7171
19	1.0994	1.2081	1.3270	1.4568	1.5987	1.7535	1.9225	2.1068	2.3079	2.5270	2.7656	3.0256	3.3086	3.6165	3.9515	4.3157	4.7116	5.1417
20	1.1049	1.2202	1.3469	1.4859	1.6386	1.8061	1.9898	2.1911	2.4117	2.6533	2.9178	3.2071	3.5236	3.8697	4.2479	4.6610	5.1120	5.6044

Appendix E

Public Notice

Example 1

This notice is intended to advise all sewer users paying fees for services provided at the Hillsboro Wastewater Treatment Facility (Facility) that the City plans to enter into an operations and maintenance service agreement with XYZ Inc. The agreement provides for a \$2.5 million contract advance payment from XYZ Inc. to the City. The City will place \$1.0 million in the City's General Fund. The remaining \$1.5 million will be placed in the City's dedicated Sewer Fund to help stabilize future user fees, as well as meet obligations to maintain and improve the Facility. A portion of the annual service fee payable by the City to XYZ Inc. will be allocated to reimburse XYZ Inc. for the \$2.5 million contract advance payment. The annual service fee to XYZ Inc. is funded from sewer user fees.

Example 2

The City of Hillsboro plans to enter into a contract with XYZ Inc. for the operation and maintenance of its wastewater treatment plant. The City will pay a fixed fee, subject to inflationary adjustment, to XYZ Inc. for its services. The contract provides that XYZ Inc. will reimburse the City for \$1 million of expenses the City incurred to conduct feasibility studies, financial analyses, compliance with Federal and State regulations, and negotiation of the contract. XYZ Inc. will also pay the City \$465,000 annually as a site access fee. This fee will accrue to the City's General Fund and will help support the General Fund services of the City including police and fire protection and other public services.

The service fee to XYZ Inc. will be paid out of the sewer charges assessed to our customers and is intended to compensate XYZ Inc. for their costs of operating the plant, their payment of the site access fee, and the one-time expense reimbursement of \$1 million to the City.

As a consequence of this arrangement, we anticipate cost savings of over \$1 million annually. These savings enable water and sewer rates for Hillsboro residents to remain unchanged in Fiscal Year 1999 (beginning July, 1998). Stable rates are anticipated in Fiscal Year 2000 as well.

City Council recently passed two key measures to utilize these savings in a manner directly beneficial to our customers. The first measure (Ordinance 1) specifies that the savings be used to improve the water and sewer infrastructure in the City. We expect to increase our investment in water mains and sewer lines in the next several years. The second measure (Ordinance 23) assists homeowners with the financial burden of replacing old and corroded water service lines when they fail unexpectedly. The typical costs of replacing a private water service line (which runs from the curb into the house) is about \$1000. Council's "service line initiative" will be administered by the Department of Public Works.

Appendix F

General Grant Regulations

For all grants awarded by the Environmental Protection Agency (EPA):

40 CFR 30.800 (Nov. 27, 1971. Superseded 18 CFR 601.27(1).) (1972 - 1974 CFRs) [Title to movable or fixed equipment, materials, or supplies shall vest in the grantee, subject to such equitable interest in the United States as may be provided for in the regulation or the grant agreement. The interest of the United States shall be adequately recorded.];

40 CFR 30.800-3 (Nov. 27, 1971. Superseded 18 CFR 601.27(1).) (1972- 1974 CFRs) [Upon written approval from EPA prior to final accounting, movable or fixed equipment, materials, or supplies may be (a) sold if the grantee pays to the United States the net proceeds of the sale or the fair market value at time of sale, whichever is greater, in the proportion that EPA assistance bears to the allowable project cost or (b) disposed of in any other manner by the grantee upon payment to the United States of such proportion of the fair market value at time of final accounting.];

40 CFR 30. 810-4 (May 8, 1975. Superseded 40 CFR 30. 800.) (1975 - 1983 CFRs) [The title to real and personal property acquired under the grant shall vest in grantee, subject to United States' interest.];

40 CFR 30.810-5 (May 8, 1975. Superseded 40 CFR 30.800-3.) (1975 - 1983 CFRs) [The grantee shall use real property for purpose of grant. When real property is no longer needed by grantee for that purpose, grantee shall request disposition instructions from EPA, which shall observe the rules in 30. 810-5(d) in the disposition instructions.];

40 CFR 30. 535 (September 30, 1983; October 2, 1984. Superseded 40 CFR 30. 810-4 and 30.810-5.) (1984 - 1988 CFRs) [Grantee must assure that EPA's interest in real property is adequately recorded. When real property is no longer needed for the project, grantee must get disposition instructions from EPA, which may choose from options specified in the regulation.];

40 CFR 31.31 (March 11, 1988. Superseded 40 CFR 30.535 for grants to State, local, and tribal governments.) (1989 - 1998 CFRs) [Grantee shall not sell or encumber its title or other interests in real property. When grantee no longer needs real property for original purpose, it request disposition instructions from EPA.];

Construction Grant Program Regulations

For EPA grants awarded under the Federal Water Pollution Control Act (FWPCA):

18 CFR 601.26(m) (May 14, 1966) (1966 and 1967 CFRs) [Grantee must have fee simple or such interest in the site of the project sufficient to assure undisturbed use and possession for purposes of construction and operation for the estimated life of the project. If the project serves more than one municipality, the participating communities must have interests or rights that assure their undisturbed use of the project for the estimated life of the project.];

18 CFR 601.27(1) (January 24, 1968. Superseded 18 CFR 601.26(m).) (1968 - 1971 CFRs) [Grantee must have fee simple or other interest in the site of the project, and rights of access, sufficient to assure undisturbed use and posses-

sion for purposes of construction and operation for the estimated life of the project; same requirement as 18 CFR 601.26(m) for projects serving more than one municipality.];

(The preceding regulations were promulgated by EPA's predecessor, the Federal Water Pollution Control Administration, Department of Interior. When EPA was created it retained these regulations until it promulgated replacements.)

40 CFR 35.840(h) (June 9, 1972) (1973 - 1994 CFRs) [same requirements as 18 CFR 601.27(1).];

For grants awarded under Title II of the Clean Water Act (the FWPCA of 1972, as amended):

40 CFR 35.935-1 (September 27, 1978) (1979 - 1998 CFR) [Grantee agrees to maintain and operate treatment works for design life.];

40 CFR 35.935-3(b)(3) (September 27, 1978) (1979 - 1998 CFRs) [Grantee must have fee simple or such interest in the site of the project, and rights of access, sufficient to assure undisturbed use and possession for the purpose of construction and operation for the estimated life of the project. If the project serves more than one municipality, participating municipalities must have interests sufficient to assure their undisturbed use of the project site for the estimated life of the project.]; and

40 CFR 35.2214(a) (May 12, 1982; February 17, 1984. Superseded 40 CFR 35.935-1 and 35.935-3(b)(3)) (1982 - 1998 CFRs) [Grantee shall maintain and operate the project to meet project performance standards including the enforceable requirements of the Clean Water Act for the design life.].

Appendix G

EXAMPLE PRIVATIZATION REVIEW REQUEST

City of Clear Stream

Via Federal Express

August 13, 1998

**Director
Office of Wastewater Management
United States Environmental Protection Agency
401 M Street, SW
Washington, DC 20460**

Re: City of Clear Stream, California - Wastewater Treatment Facility Privatization Agreement

Dear Director:

The City of Clear Stream, California (City) and New Water Operating Services (NWOS) have agreed to enter into a privatization contract which will commence immediately upon receipt of the required EPA approval. The City last received a Federal wastewater construction grant in 1981. Based on this grant, the City is seeking EPA review and approval under Executive Order (E.O.) 12803, issued in 1992. Enclosed are four (4) copies of the Privatization Executive Summary for EPA review, along with four (4) copies of the underlying contract. The Privatization Executive Summary for EPA Review closely follows the outline of the requirements in your Agency's guidance.

Due to overloading of the existing wastewater treatment facility, weather related emergencies recently encountered, and the need to provide additional treatment capacity for future growth, the City is seeking an expeditious EPA approval.

Key Contract Terms and Conditions

Following are the key contract terms and conditions:

- The Contract is between the City of Clear Stream, California and New Water Operating Services, a division of New Water, Inc., a NYSE listed company.
- The contractor will provide operations and maintenance (O&M) services for a 20-year period, commencing immediately upon receipt of State and Federal regulatory approval.
- The contractor will provide the financing and design, permit, and construct the identified wastewater treatment plant expansion and improvements needs in order to provide adequate capacity to serve the City's current wastewater treatment needs and to provide treatment capacity for the City's projected future growth.

- The contractor will conduct monitoring of industrial users as required under the Municipal Industrial Pretreatment Program (“MIPP”) and assist the City in administering the MIPP. The City will retain sole responsibility for adoption and enforcement of the MIPP.

The City of Clear Stream received a Federal Grant to expand the wastewater treatment plant on September 29, 1981, in the amount of \$2,213,363. The expanded plant was placed-in-service on June 12, 1984. Based on the placed-in-service date and using the IRS Modified Accelerated Cost Recovery System, 15-year, half-year convention schedule, the City is subject to grant recapture in the amount of \$65,294.20 ($\$2,213,363 \times 2.95\%$ (i.e., year 16 of the 15-year MACRS table)) for the Federal grant.

Thank you for your timely assistance in reviewing this proposed agreement. Please contact me if you need any additional information.

Sincerely,

John Doe
City Manager,
Clear Water, California

EXAMPLE PRIVATIZATION DEVIATION REQUEST

City of Clear Stream

Via Federal Express

August 13, 1998

Grant Administration Officer
Grant Management Office
United States Environmental Protection Agency
Region IX
75 Hawthorne Street
San Francisco, CA 94105

Re: City of Clear Stream, California- Wastewater Treatment Facility Privatization Agreement

Dear Grant Administration Officer:

The City of Clear Stream, California (City) and New Water Operating Services (NWOS) have agreed to enter into a privatization contract to finance, design, and build an expansion to the existing wastewater treatment facility and provide contract operation and maintenance services for 20 years. The plant expansion will increase the design capacity to 2.0 mgd. Clear Stream will retain ownership of the wastewater treatment system and facilities.

The Clear Stream County Sanitation District received an EPA wastewater treatment construction grant on September 29, 1981 for \$2,213,363.

The City is requesting a deviation from 40 CFR 30.810-4 (1981) that states the "...title to real property or personal property whose acquisition is a direct cost under a grant project shall vest in the grantee, subject to such interest in the United States...". Approval of this deviation will allow Clear Stream to privatize its wastewater treatment plant. A deviation is required because the privatization contract between the City and NWOS is a disposition agreement that provides for the transfer of non-operational funds from NWOS to the City.

Attached to this letter are two copies of the Executive Summary of the privatization agreement and the proposed contract between the City and NWOS.

Thank you for your timely assistance in reviewing this deviation request. Please contact me if you need any additional information.

Sincerely,

John Doe
City Manager
Clear Water, California

Attachments:

cc:
EPA Privatization Coordinator, Washington DC

